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Editor's note: This letter was revised Feb. 18, 2022, to correct estimates in the tables for the various scenarios considered.

February 18, 2022

Dr. Rajeev Darolia
Wendell H. Ford Professor of Public Policy
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University of Kentucky
413 Patterson Office Tower
Lexington, KY 40506-0027

Dear Dr. Darolia:

This letter is intended to provide updated estimates from those included in our letter sent on October 27, 2021. Due to updates in our simulator tools, some estimates have been revised. The Department of Education's first session of negotiated rulemaking meetings ran from October 4th – 8th. Before the session started, the Department released issue papers outlining questions and proposed regulations for the committee to consider. Among other important financial aid topics, reforming income-driven repayment plans was a central focus of the discussion. As prior Pew research has summarized, despite offering affordable payments and reduced risk of delinquency and default to many borrowers, those enrolled in IDR often report unaffordable payments, growing balances, and confusing enrollment processes. The IDR issue paper and subsequent discussion focused on changes to the underlying IDR formula that could help address some of these issues.

To understand how some of the changes under consideration could affect repayment outcomes, we model potential changes to the IDR formula discussed by the negotiated rulemaking committee based on the design of the REPAYE repayment plan, the most generous income-driven repayment plan. Under REPAYE, payments are set at 10% of discretionary income, with 150% of income relative to the Federal Poverty Level (FPL) exempted from the payment calculation. Payments are required for 240 months for undergraduate borrowers and 300 months for graduate borrowers if borrowers do not pay off their loans earlier, with the remainder of loan balances forgiven. The three reform options discussed are:

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1. Lowering the percentage of discretionary income used to calculate payments from 10% (the figure used for the most recent and commonly used plans) to 5%.
2. Increasing the amount of income protected from the payment calculation.
   a. Current plans exempt 150% of the federal poverty guideline from borrowers' incomes and uses the difference to calculate payments.
3. Limiting interest accrual in IDR plans to that which a borrower would accumulate if they were enrolled in a Standard repayment plan.

Baseline estimates

To estimate the effects of potential changes to the IDR formula, we created a set of example borrowers, with income, debt, and annual increases in income estimated for borrowers without a degree, an associate degree, a bachelor's degree, and a graduate degree. Median incomes for these example borrowers were produced using the 2016 American Community Survey; median federal loan balances were produced using the 2016 National Postsecondary Student Aid Study and 2012/2017 Beginning Postsecondary Students Longitudinal Study.

To reflect realistic repayment scenarios, borrowers are assumed to have dependents, with marital status and number of dependents for each example borrower produced using the 2016 American Community Survey. The interest rates used are the rates for loans disbursed during the current academic year. The FPL is assumed to increase by 2.42% each year, in keeping with the increase assumed by the Office of Federal Student Aid's Loan Simulator. See the attached methodology for an explanation of our assumptions related to borrowers' starting income, income growth, balance size, and family size. Due to data limitations, graduate borrower examples are for single borrowers, rather than reflecting an estimated family size. For context, single borrowers have a smaller amount of income protected by the FPL guideline than borrowers with families. This may make their monthly payments, and total amount paid, larger over time.

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Table 1: Borrower Assumptions

	No Degree	AA	BA	Graduate
Repayment Inputs				
Income	$26,725	$38,780	$53,450	$66,220
Debt	$9,070	$22,200	$43,900	$55,450
Average Annual Income Increase	0.50%	1.50%	2.50%	3.50%
Interest Rate	3.73%	3.73%	3.73%	5.10%
Family Size				
Married	No	No	Yes	No
Dependent Children	2	2	2	0
Total Family Size (Including Borrower)	3	3	4	1

And as a baseline for this analysis, here are the repayment outcomes we estimate for borrowers who are enrolled in REPAYE.

Table 2: Estimated REPAYE outcomes

	No Degree	AA	BA	Graduate
Monthly Payment Range	$0-0	$1-52	$118-196	$392-645
Total Amount Paid	$0	$7,116	$36,950	$80,906
Projected Loan Forgiveness	$12,714	$27,562	$40,191	$0
Repayment Period (in months)	240	240	240	161

Monthly payment amounts are reported as ranges between the lowest and highest payment required throughout repayment. Under the current REPAYE formula, a borrower who has not completed their degree will not be required to make payments at any point in repayment. As such, their full balance remains at the end of the repayment period and is eligible for forgiveness. In contrast, the associate's and bachelor's degree holders make payments throughout repayment and have a forgiveable balance;

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the graduate degree holder repays more than their original balance and fully repays significantly ahead of the 300-month forgiveness threshold.

Lowering the percentage of discretionary income used to calculate payments to 5%

The first option modeled lowers the percentage of discretionary income used to calculate payments from 10% to 5%. Lowering the payment calculation to 5% has a sizable impact on each borrowers' monthly payment range, total amount paid, and projected loan forgiveness. The difference between REPAYE and the proposed changes are noted in parenthesis; changes that decrease these factors are noted in green, while those that increase these factors are noted in red.

Table 3: Estimated outcomes with 5% of discretionary income used to calculate payments

	No Degree	AA	BA	Graduate
Monthly Payment Range	$0-0	$1-26 (-$26)	$59-98 (-$98)	$196-488 (-$157)
Total Amount Paid	$0	$3,558 (-$3,558)	$18,475 (-$18,475)	$96,611 (+$15,705)
Projected Loan Forgiveness	$12,714	$29,340 (+$1,779)	$52,301 (+$12,110)	$23,054 (+$23,054)
Repayment Period (in months)	240	240	240	300 (+139)

While payments remain at $0 throughout repayment for the borrower with no degree (similar to their current outcome in REPAYE), borrowers with associate's, bachelor's, and graduate degrees see significant decreases in their monthly payments throughout the course of repayment.

The total amount paid for each example borrower would be roughly half of what they would pay under the current REPAYE design, except for the graduate borrower, who would repay more than what they would repay under the current REPAYE plan.

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This is because their lowered payments cover less of the monthly accruing interest, allowing the balance to grow over time and extending the length of the repayment term.

Accordingly, projected loan forgiveness for every borrower scenario would also be much higher in this scenario compared to repayment in REPAYE. The decreased monthly payments cover less of the accruing interest each month, resulting in a greater balance eligible for forgiveness at the end of repayment. For the borrower with a bachelor's degree, they would have nearly $12,000 more eligible for forgiveness than they would under the current REPAYE plan design. The graduate borrower would now qualify for significant forgiveness, while they would have paid off their loan prior to the forgiveness threshold under the current plan design.

Increasing the amount of income protected from the income-driven payment calculation by the Federal Poverty Level (FPL) guideline

A second option could be to increase the amount of income protected using FPL guidelines to make payments more affordable for borrowers. For example, here is how repayment would be affected if the Department exempted 200% of the FPL from borrowers' income—a 50 percentage point increase over the current 150% used in REPAYE payment calculations.

Table 4: Estimated outcomes with 200% of the FPL exempted from borrowers' incomes

	No Degree	AA	BA	Graduate
Monthly Payment Range	$0-0	$0-0 (-$52)	$9-24 (-$172)	$339-620 (-$25)
Total Amount Paid	$0	$0 (-$7,116)	$3,755 (-$33,195)	$85,728 (+$4,822)
Projected Loan Forgiveness	$12,714	$31,120 (+$3,559)	$59,661 (+$19,470)	$0
Repayment Period (in months)	240	240	240	186 (+25)

As in the 5% income option, increasing the FPL to 200% has no effects on the example borrower with no degree, as they already

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would not make any payments. However, the borrower with an associate degree would now also not make any payments at any point during repayment. Monthly payments for the borrower with a bachelor's degree are significantly lower than what they would be under the 5% of discretionary income proposal—which may help borrowers as they graduate and get started with their careers in lower-paying positions. In contrast, monthly payments would be slightly higher for the graduate borrower in this scenario than in the 5% income scenario.

Because of these factors, the borrower with a bachelor's degrees repays a lower total amount than they would under the 5% income option. Accordingly, the remaining balance eligible for forgiveness for associate's and bachelor's degree borrowers is higher than the 5% reform option because of lower totals paid over time. The graduate borrower repays more than in REPAYE, but less than what they would under the 5% of discretionary income scenario. This leads to a situation where, under the 200% FPL scenario, the graduate borrower would pay off their loans well before the same borrower would under the 5% scenario.

As seen in Table 5, increasing the percentage of the FPL guideline that protects borrowers' income even further to 250% has a similar but more pronounced effect.

Table 5: Estimated outcomes with 250% of the FPL exempted from borrowers' incomes

	No Degree	AA	BA	Graduate
Monthly Payment Range	$0-0	$0-0 (-$52)	$0-0 (-$196)	$144-616 (-$29)
Total Amount Paid	$0	$0 (-$7,116)	$0 (-$36,950)	$92,710 (+$11,804)
Projected Loan Forgiveness	$12,714	$31,120 (+$3,559)	$61,538 (+$21,347)	$0
Repayment Period (in months)	240	240	240	219 (+58)

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An increase to 250% would make this reform option a more substantial benefit than lowering the share of discretionary income used to calculate monthly payments to 5%. If increased to 250%, the median borrower with a bachelor's degree would now also never make payments.The effect for graduate degree borrowers is more nuanced. Raising the FPL protected amount to 250% would lead to the graduate borrower having lower payments, but paying a larger amount over time than in the 200% scenario, as the lower monthly payments resulting from raising the FPL would extend the time until this borrower would receive forgiveness.

Capping interest accrued at what would be paid in the Standard Plan

Affordable payments are an important part of the repayment equation, but research also shows that growing balances may cause borrowers to disengage with the repayment system, as the prospect of forgiveness may seem intangible. Limiting the amount of interest repaid in an IDR plan is one way to prevent growing balances, and may be an important route to consider as reform options that lower payments may also increase the amount of unpaid interest that borrowers accumulate. For example, Table 6 shows how amounts repaid in REPAYE would differ if interest accrual were capped at the amount of interest that would accumulate for the same borrower if they were enrolled in the Standard, 10-year repayment plan.

Table 6: Estimated outcomes if interest is capped at the Standard Plan

	No Degree	AA	BA	Graduate
Monthly Payment Range	$0-0	$1-52	$118-196	$287-621 (-$24)
Total Amount Paid	$0	$7,116	$36,950	$72,559 (-$8,347)
Projected Loan Forgiveness	$11,083 (-$1,631)	$20,012 (-$7,550)	$16,694 (-$23,497)	$0
Repayment Period (in months)	240	240	240	148 (-13)

While affordability as measured by monthly payment range changes very little as a result of capping interest alone, total amount projected for forgiveness generally decreases for each example borrower, as less interest is able to accrue throughout

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repayment. However, the graduate borrower repays less overall, and pays off the loan roughly a year faster than they would under REPAYE. Limiting balance growth caused by interest accrual may lessen the amount of discouragement felt by borrowers and could potentially decrease the ultimate cost of forgiveness to the federal government.

Conclusion

Income-driven plans are an important tool that can help borrowers avoid delinquency and default, and enrollment in such plans has increased substantially over the past decade. However, research suggests they can be further improved to help struggling borrowers make more affordable payments and to reduce balance growth across the portfolio. The reforms modeled above are just a few of many potential options that the committee can pursue throughout this fall's rulemaking session. Such reforms could be implemented individually or done at the same time to amplify the benefit to borrowers. As policymakers move forward with reforms, they should weigh the benefits and drawbacks of how different plan design approaches would impact those most likely to be delinquent or default on their loans, or experience balance growth over time.

The Pew Charitable Trusts appreciates the opportunity to provide this data to you and the negotiators. We welcome any questions you might have. Please be in contact with Regan Fitzgerald, Manager, the Project on Student Borrower Success, rfitzgerald@pewtrusts.org.

Sincerely,

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Regan Fitzgerald
Manager

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