7-1-1986

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by David M. McDermott

Within the last decade there has been a major shift in the distribution of federal financial aid. In 1984-85, loans comprised 51 percent (Gillespie, 1983) of all financial aid awarded. This is a substantial change from 1975-76, when loans comprised 16.9 percent of all aid awarded (Gillespie, 1984). This migration in distribution from a primary dependency on grants to a significant and growing reliance on loans, reflects a national trend toward an increase in the self-help component of the financial aid package. Given the present state of our national economy, it is unlikely that we will see a return of the strong federal student financial aid grant support of the mid to late 1970's. The current Administration's approach in addressing the growing concern over the federal budget deficit is likely to result in further reductions of federal support for student aid. Since reductions of some magnitude appear inevitable, it is important to examine the true cost of student aid programs to the federal government.

Analysis of the costs associated with each federal student aid program will provide a measurement upon which to base policy decisions. A measurement reflecting true cost will allow optimum program changes to meet the need of reducing the federal deficit, while continuing to supply aid for education in a cost effective manner.

The present Administration is advocating less grant aid and more self-help aid in the form of work and loans. Simultaneously, they are supporting the reduction or elimination of the National Direct Student Loan (NDSL), a program that is the least costly to the federal government, and a great benefit to students.

As this study demonstrates, federal grant aid is more costly than college work-study or loan programs. The Pell Grant Program costs the federal government $1.00 for every dollar granted. The administrative allowance paid to institutions and the hidden indirect costs of operating the program increase this cost. In the Supplemental Educational Opportunity Grant (SEOG) program, the cost is $1.05 for every dollar granted. In the College Work Study (CWS) program the cost is $.85, including administrative costs, for every dollar earned by the student. The federal cost in the CWS program is reduced because of the institution's 20 percent matching requirement. Therefore, the federal cost for the work study program ($.85/$1.00) is less than that of the grant programs.

The revolving NDSL funds being built at institutions have tremendous potential. If the revolving federal contributions are properly managed, they can be loaned, collected and reloaned. The federal education loan programs such as the NDSL, Health Professions, and Nursing Loan Programs, which have this revolving fund aspect, can benefit future generations of students. Many institutions have reached a full revolving fund status and receive no new federal capital contribution (FCC). For fiscal year 1985, for instance, NDSL collections represent 36 percent of all Title IV campus based aid available.

In the NDSL program, the revolving fund is comprised of: new federal capital,

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contribution, the 10 percent institutional matching monies, repayments from borrowers (including principal and interest), interest earnings from investment, and federal reimbursements for cancellations. These combined sources are used to make loans to students, pay the extraordinary costs of collections, such as legal fees and collection agency charges, and may be used to pay the administrative allowance to the institution.

The institution is responsible for paying all routine costs for collecting the loans. For every dollar lent, the institution receives an allowance of $.05. However, the institution pays for the cost of awarding that dollar as well as the routine costs of administering that loan while the student is in school and for the entire repayment period, which can exceed ten years. For the NDSL program the interest paid by the student remains in the fund for future loans. In contrast, for the Guaranteed Student Loan program the lender retains the interest paid by the borrower. The lender also receives additional interest in the form of special allowances during the repayment period, which also may exceed ten years. The difference in the way the interest is handled in these two programs should result in a lower cost per dollar lent to the NDSL program.

Defaults in the NDSL program do not cost the federal government at the time of default. They do cause the fund to revolve at a slower rate. However, in the GSL program, defaults cost the federal government almost immediately. Furthermore, the default rate in the NDSL program has been steadily declining (See Table 1). In 1979, the national NDSL default rate was 11.9 percent. By 1983, it declined to 9.48 percent and by 1984, 8.96 percent. The U.S. Department of Education projects that by 1988, the default rate will be down to 7.71 percent.[2] As of September 1984, the lender default rate in the GSL program was 10.7 percent and the net default rate was 4.4 percent. Although these rates are computed differently, it appears that the NDSL default rate is declining rapidly while the GSL default rate may be stabilizing.

Table 1
NDSL Default Rates

1979	Actual	11.90%
1980	Actual	11.88%
1981	Actual	11.10%
1982	Actual	10.49%
1983	Actual	9.48%
1984	Actual	8.96%
1985	Projected	8.79%
1986	Projected	8.39%
1987	Projected	8.03%
1988	Projected	7.71%

Table 2 shows that as of June 30, 1983, the cumulative federal cost for the NDSL program had dropped to $.56 per dollar loaned. At the inception of the NDSL program, the federal cost was $.90 per dollar lent. However, each year as collections come in and are reloaned, the effective federal cost per dollar loaned declines. Assuming maintenance of the current level of funding, by 1988, the cost will decline to $.45 per dollar loaned. The actual single year fiscal 1983 federal government cost in the NDSL program was $.30 per dollar loaned. If new FCC remains constant, the single year cost will be $.21 per dollar lent in 1988. This is based upon the Department of Education's unofficial projections for collections.

Table 2
Schedule of NDSL Cost-Benefits
($ Millions)
For the Actual Year 1982-83 and Projected Years 1983-88

NDSL-Cumulative Cost Computation	Cumulative Actual FY 82-83 (1)	Projected FY 83-84	Projected FY 84-85	Projected FY 85-86	Projected FY 86-87	Projected FY 87-88
Cumulative Prior Year FCC	4,656	4,848	5,041	5,222	5,437	5,652
New FCC	166	178	161	190	190	190
Cancellation Reimbursements	74	15	20	25	25	25
Less Repayments of FCC	(48)	-	-	-	-	-
Cumulative Federal Costs	4,848	5,041	5,222	5,437	5,652	5,867
Collections** Principal Plus Interest	3,808	549	616	691	773	865
New FCC	4,774	178	161	190	190	190
New Institutional FCC Match	575	20	18	21	21	21
Cancellation Reimbursements	74	15	20	25	25	25
Other Income	34	5	5	6	7	8
Less 5% Administrative Expense	(288)	(36)	(38)	(43)	(47)	(52)
Less Unusual Collect, Legal & Other	(114)	(16)	(18)	(21)	(23)	(25)
Less Cash Balances & Other Adjustments	(192)					
Subtotal-Current Year-Increase New Loans	-	715	764	869	946	1,032
Cumulative Prior Year Loans	-	8,671	9,386	10,150	11,019	11,965
TOTAL CUMULATIVE LOANS	8,671	9,386	10,150	11,019	11,965	12,997
CUMULATIVE COST PER $ LOANED	.56	.54	.51	.49	.47	.45
CURRENT YEAR COST COMPUTATION						
Current Year New FCC	166	178	162	190	190	190
Cancellation Reimbursements	14	15	20	25	25	25
Current Federal Costs	180	193	181	215	215	215
Current Year New Loans (Above)	597	715	764	869	946	1,032
CURRENT YEAR FEDERAL COST PER $ LOANED	.30	.27	.24	.25	.23	.21
DEFAULT RATE (2)	9.48%	9.23%	8.79%	8.39%	8.03%	7.71%

(1) Based on partially edited data from the Fiscal Operations report
(2) Based on Department of Education projections

In contrast, the true cost per dollar of loans in the GSL program would include the federal costs for the entire period the loan is outstanding, which can extend beyond ten years after the student leaves school. The costs which are incurred after the first year will be referred to as an unfunded liability of the GSL program. In fiscal year 1984, $3.4 billion was spent on the GSL program, primarily to cover the unfunded liabilities from past GSL loans. Additionally, there were $7.9 billion in new loans originated. As Table 3 illustrates, in fiscal year 1984 alone, the cost was approximately $.43 per dollar loaned.

Table 3
GSL Program Costs (1)

		Total Costs ($ Billions)	Annual Cost Per Dollar Loaned (Cents) (2)
1977	Actual	.5	.35
1978	Actual	.7	.36
1979	Actual	.9	.33
1980	Actual	1.5	.31
1981	Actual	2.6	.34
1982	Actual	2.9	.47
1983	Actual	2.5	.36
1984	Actual	3.4	.43
1985	Projected	3.7	.46
1990	Projected at 5.1% T-Bill	2.8	.26
1990	Projected at 10% T-Bill	5.4	.50

(1) After subtraction of loan origination fees, started in 1982, insurance premiums and collections.

(2) Not including unfunded liabilities extending into future periods.

Using the 10 percent T-bill rate, the Department of Education estimates the long range and short range federal costs of a typical GSL loan to be $.65 per dollar loaned (see table 4). This figure does not include the additional costs to the borrower in origination fees and insurance premiums. These figures contrast with the NDSL single year program cost of $.27 per dollar loaned for 1984. By 1988, the projected cumulative cost will be $.45 per dollar loaned. Furthermore, the 1984 $7.9 billion in new GSL loans created an unfunded liability of between $4.0 and $4.5 billion. The cumulative effects of these unfunded liabilities will, if unchecked, continue to increase.

In recent years, GSL costs have increased rapidly. They are becoming a substantial portion of the funds available for all student aid. In 1977, the net costs of the GSL program were $.5 billion; by 1980, $1.5 billion; by 1983, $2.5 billion and by the close of the fiscal year 1985, the costs are projected to be $3.7 billion.

The Administration's proposal to limit GSL eligibility may be an attempt to reduce the cumulative problems created by unfunded liabilities from past years. As the eligibility criteria for GSL and NDSL become increasingly alike, the long range cost per dollar lent and the ability to control total expenditures should be carefully considered.

Table 4
Estimated Federal Costs of a Typical GSL Loan for $1,000

Interest Benefits (1)	$240.00
Special Allowance (2)	357.50
Subtotal Interest Subsidies	597.50
Other Subsidies (3)	10.00
Defaults & Other Claims (4)	120.00
Total Costs	$727.50
Total Receipts (5)	83.00
Net Cost	$644.50
Net Cost Per Dollar Loaned	$ .65

Notes:

(1) Assumes three year in-school/grace period.

(2) Assumes seven year repayment period for a total loan life of ten years. A flat ten percent is assumed for the 91 day T-Bill rate.

(3) Assumes one percent administrative cost allowance to the guarantee agency.

(4) Assumes a twelve percent likelihood of the loan resulting in a claim to default, bankruptcy, death or disability of borrower.

(5) Assumes receipts of five percent loan origination fee ($50) as well as a thirty percent likelihood of collecting on any possible default ($33).

If the GSL program was terminated today the effects of the unfunded liabilities would still be between $.5 billion and $1.2 billion by 1990. The costs vary depending upon T-bill rates. Based on the current volume of outstanding GSL loans, an increase in the T-bill rate from 10 percent to 11 percent will cost the government $.3 billion more per year. That is almost as much as the total expenditures in the SEOG program and 1-1/2 to 2 times the new FCC capital going into the NDSL program. Therefore, the GSL program not only has a problem with unfunded liabilities but also with uncontrolled costs.

Assuming a 5.1 percent T-Bill rate and loan volume of $10.8 billion, the projected cost of the GSL program will be $2.8 billion by 1990. This optimistically calculates out to a cost of $.26 per dollar loaned. However, if the 1990 T-bill rates are 10 percent, as they were in fiscal year 1984, costs will increase to $5.4 billion. This is a $2.6 billion increase. The cost per dollar loaned would increase from $.26 to $.50.

The three key factors then to remember when evaluating the NDSL program are: first, a long term resource is being created in the revolving fund; second, the program is cost effective; and third, that costs are controllable. The projected long range federal cost per dollar granted, earned, or loaned under the major Title IV student aid programs is approximately $1.00 for PELL, $1.05 for SEOG, $.85 for CWS, $.65 for GSL and $.45 for NDSL. The NDSL figure will decline further as the positive effects of the revolving collections continue beyond 1988. During Reauthorization, the continued existence of each of the loan programs will be considered. In this process, the NDSL program should be defined to the critics as we consider the long range and short range costs of the programs as well as the ability to control future costs.

There is a need for both programs. However, perhaps more of the GSL costs should be borne by the borrower. Several changes in the GSL program would significantly reduce the unfunded liability to the federal government. For example, if the yield on the loan was calculated at 1 percent above the T-bill rate while the borrower was in school, and the borrower was required to pay the full cost during the repayment period, costs would be significantly affected. In this example, if T-bill rates were 9 percent, the government would be responsible for paying a 10 percent yield (9 percent + 1 percent) only during the time the borrower was in school. Currently, the yield realized by most banks is 3 1/2 percent over the 91-day T-bill rate. A 9 percent T-bill rate results in a yield to the lender of 12 1/2 percent. Since the loan is fully guaranteed by the federal government, and the risk to the bank is minimal, it can be argued that this yield is unnecessarily high.

By 1990, the projected volume of GSL loans will result in $.5 billion saved per each 1 percent reduction in the interest rate. The savings generated due to GSL program changes could be used to fund the new FCC to the NDSL program.

As the programs exist today, they are analogous to the decision we all face of buying or renting a home. In the NDSL program, the federal government and the institution are partners in building equity in the fund. The first year costs are higher by virtue of having to make a down payment. However, at some point in the future the loan will be fully repaid. In the GSL program, the federal government is paying rent for the use of the funds. No equity is being built. The rate charged is uncontrolled, and the rent continues as long as funds are needed by students. The long range cost benefit relationships of these programs should seriously be considered when making decisions about their future.

References

Gillespie, Donald A., and Carlson, Nancy. *Trends in Student Aid 1963 to 1983.* Washington, D.C.: The College Board, 1983. Table A-4, p. 35.

Gillespie, Donald A., and Quincy, Lynn. *Trends in Student Aid 1980-1984.* Washington, D.C.: The College Board, 1984. Table 4, pg. 7.

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[1]This article is a slightly revised version of a policy paper prepared for the Coalition of Higher Education Assistance Organizations in May, 1986.

[2]Data used in this analysis include information received on an informal basis from the U.S. Department of Education. Information received from this source is believed by the author to be accurate, but has not been subject to independent analysis.