

## **Overview of Income Contingent Student Loan System**

Fianna Fáil will introduce an income contingent loan system to enable students in both the Higher and Further Education sectors to avail of inexpensive, deferred payment loans. The outcome of this loan system will give students the option of availing of a low-cost loan both to pay their costs of tuition (the student contribution fee) and to cover some (or all) of their cost of living and maintenance while undertaking their education and training.

### **➤ Eligibility for Loans**

All undergraduates (full and part time) and apprentices undertaking a post-secondary course in university, college or institute of technology (in Ireland) including those in receipt of Student Support Grant (maintenance grant or student contribution fee grant).

The loan will also be available to post-graduates undertaking either a research or taught course in a higher education institution (including Master and Post-Graduate Diploma degrees).

### **➤ Loan terms for those enrolling from in Year 1 (assumed to be 2017/2018).**

Loans will be available to new entrants only (both undergraduate and post-graduate, enrolling for 2017/2018 onwards).

Loans are subject to 'income-contingent' repayment: graduates only begin to make repayments based on of gross income above a 'repayment threshold' (€30,000 in 2016 prices). If a graduate's income falls below this threshold at a future point, loan repayments also freeze. The income threshold is subject to revision at future dates, subject to trends in employment, earnings and inflation.

For undergraduates, minimum monthly loan repayments are calculated based on a 15 year loan repayment period, at 3 % simple interest rate. For instance, a graduate who undertakes a three year degree and takes out an average student loan each year, which is €3,450 (€10,350 on graduation), would have to repay €77 per month over a 15 years. Since there is a simple rather than a compound interest rate, recipients can also have the option to repay their loan earlier or in

a lump sum, without this having a negative effect on the overall repayment. Loan recipients who repay over a longer time frame due to a gap in their earnings, can have the option of paying a higher monthly repayment to account for the gap in repayments or they can simply extend the loan period.

For postgraduate students, the minimum monthly loan repayments are based on a 10 year repayment period, at 3 % simple interest rate. For instance, a postgraduate who undertakes a one year degree course and takes a €10,000 loan will be liable to repay €83 per month over 10 years. Post-graduate loan recipients also have the option to repay their loan in a shorter time frame than 10 years.

It is estimated that undergraduate students require approximately €3,852 per year to cover maintenance expenses. In addition to this, ‘free fee’ students who are required to pay the student contribution fee (around 53% of total new entrants) require an additional €3,000 per year to cover their tuition expenses.

Based on this, it is estimated that students currently in receipt of some form of maintenance grant, have a demand for loans ranging from €857 (for a student in receipt of full adjacent rate grant) to €3,547 (for a student in receipt of a part (25%) non-adjacent rate grant). It is expected that students who are not in receipt of any grant assistance will have a demand for loans in the region of €6,852 per annum. In addition to this, it is expected that postgraduate students will have a demand for loans of around €10,000 per annum (usually postgraduate degrees are of one to two years duration).

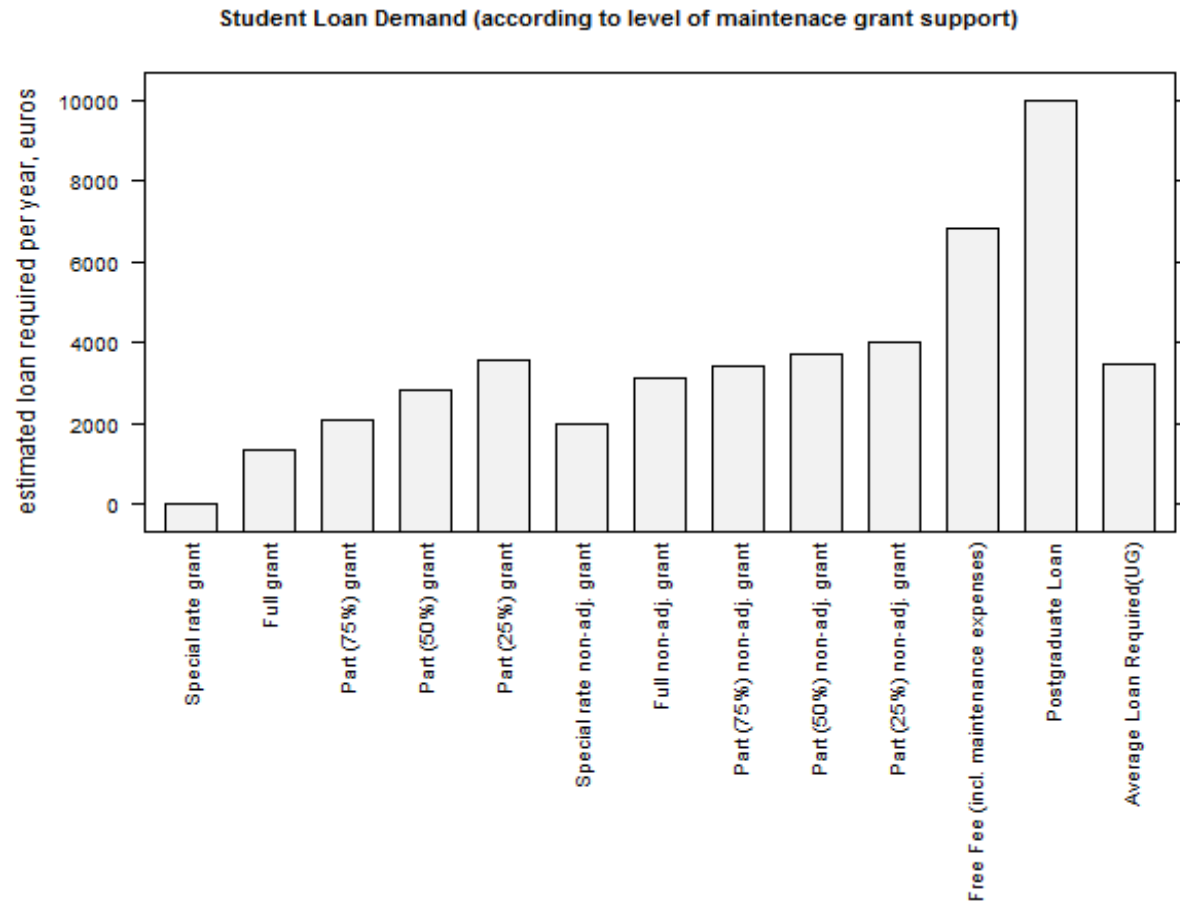
It is important to note that the limits above are guidelines only. Borrowing caps will be set according to general estimated ability to repay criteria (e.g. graduates of expensive postgraduate courses, such as graduate-level medicine, may be eligible for higher loans based on the expectation that graduates will be have a high ability to repay).

From the point at which they are issued (usually, September) until the April after graduation, loans will be subject to a simple interest rate of 3% per year. The interest will accrue over periods when loan recipients’ earnings are not over the repayment threshold. Access to the loan facility will be automatic, not determined by ability to provide collateral or guarantees from third parties.

The repayment threshold (initially €30,000 gross income) may be increased (or decreased) at consecutive intervals (from 2017 onwards) in line with national average earnings.

If loans are not repaid after 30 years after graduation, any remaining student loan debt is written off. This is known as the ‘repayment period’. The reasoning behind loan forgiveness, as in other income contingent student loan systems, is that if a loan is not repaid after 30 years it is an indication that the graduate has

not earned enough over their work life cycle to validate the original outlay for their education. Debt is also written off in the event of death or permanent disability (meaning that the individual can never work).



## ➤ **Schedule of Loan Repayments**

Graduates undertaking three-year courses starting in Oct. 2017 will become liable to start making repayments in Oct. 2021, one year after finishing their course. The first cohort of postgraduate loans will become eligible to begin repayments post-graduation in 2018. It is estimated that approximately 11,287 students would take out a loan in the first and subsequent years.

Based our estimates, if repayment threshold was €30,000, according on the HEA Graduate First Destination<sup>1</sup> survey about 25% of undergraduates would be in a position to make a repayment in the first or second year. For postgraduates, around 50% will be eligible to for making repayments in their first or second year after graduation.

Total annual repayments by graduates increase as graduate earnings increase, but peak as high-earning graduates reach the point of having paid off their loans and cease making repayments. By about 2037, all repayments from the cohort of students that entered university in 2017 will have ceased as graduates reach the end of the repayment period. This is based on the idea that if those earning €30,000 begin repaying 5 years after graduation, it will take (at a maximum) 17 years to clear loans fully. At this point, the loan system should be fully self-financing. However, long prior to this period, the loan facility would be largely self-financing.

Public debt (in real, discounted terms) would increase until the additional loans made to students on courses that last longer than three years are greater than the early repayments made by graduates – but from then on the repayments received result in a reduction in the outstanding public debt.

This would mean that public debt would increase until the point that the graduate cohort of 2020 began to resemble the general income distribution, which occurs somewhere between 5 and 10 years post-graduation.

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<sup>1</sup> HEA (2014)

➤ **Administration via ‘Student Finance Management Authority’ (SFMA)**

Loan System will be administered by new body managed within the NTMA, whose mandate will be to achieve a return on student loans equal to the cost of State borrowing. To keep the costs of the overall loan system to the State manageable, ensuring there is an adequate rate of interest on the loans is extremely important. The right rate is broadly equal to the Government's long-term cost of borrowing, for example, the rate of interest on government bonds.

The SFMA sets fixed rates on annual loan tranches, based on the State long-term cost of borrowing (approx. 2%) plus an additional percentage point to cover administration costs. It is expected that a simple interest rate of 3% would be adequate to both cover these objectives without incurring a long term loss to the public purse.

There is also the possibility to implement targeted interest subsidies for those with low earnings. In addition, there is a strong case for phased forgiveness of loans for some public service workers, for example public school teachers and nurses.

While the SFMA will be in charge of the overall administration and regulation of the income contingent loan system, it will not be primarily responsible for collecting repayments from graduates directly. Repayments on income contingent loans are akin to a ‘capped’ graduate tax, so the right place to file them is as a payroll deduction like PAYE or PRSI. Repayments will be deducted directly along with taxes by the Revenue Service and transferred directly to the SFMA. This method of collection is has important policy implications for two reasons.

First, using the Revenue will reduce the administration and transaction costs incurred by the system.

Second, having loan repayments linked directly (via payroll deductions) to ability to repay, removes any significant debt risk for student loan recipients. Since repayments are automatic, there is no possibility of individuals getting into arrears either voluntarily or involuntarily (e.g. if they lose their job) as deductions cease during periods when a graduate’s income ceases. This will remove the debt risk of student loans.

While loan debt may reduce a recipient’s borrowing capacity, it will not do so by much, since monthly repayments will be a relatively small fraction of earnings.

### ➤ **Public Borrowing Requirement**

The government would have to borrow an estimated € 75 million per year to fund the loan facility.

Based on a number of assumptions, the annual borrowing requirement will be roughly this amount minus repayments on existing loans. Repayments will begin in 2018 however these will only be from postgraduate loans. Based on the assumption that all recipients partake of the average postgraduate loan, we assume that 50 % of post-graduate students will be in a position to make a loan repayment in 2018/2019. These repayments would only amount to about €1.18million in 2018, €2.36million in 2019 and €3.54 million in 2019. However, overall repayments are expected to grow at a faster rate after 2020 when the first tranche of undergraduate loans (those who began third level in 2017) will be eligible for beginning repayments.

In terms of the annual public borrowing requirement, the state will have to borrow to cover the shortfall between new outlays and loan repayments. Therefore as repayments increase over time, the sum of public borrowing will decrease over time. As the graph below demonstrates, net public borrowing will peak in 2028 at about €875 million. From that point, net public borrowing declines quite rapidly as more and more graduates from the initial loan tranches earn incomes above the repayment threshold, and/or become higher earners able to make larger repayments.

While the net public borrowing is a significant sum, especially in the initial period, the majority of government borrowing used to finance the Student Loan book is an asset rather than a fiscal expense or a liability. This means that it does not add to the long term debt position of the government. However, since the loan book would be considered an “illiquid asset”, new borrowing to cover student loans would add to public sector debt. To reduce the public sector debt position, there is the option of disposing of the student loan book assets to the private sector. This could be done via the NTMA, not unlike a government bond float. For instance, in the UK the government occasionally sells student loan tranches onto the private sector to be used as a form of securitisation. Importantly, such a sale would have no effect on the operation of the loan system from the point of view of individuals.

## **Contribution to the Budget Current Expenditure**

Since Student loans are given on "soft terms", in that they have more favourable terms and conditions attached to them than if students were to borrow the money commercially.

They are, therefore, effectively subsidised. This subsidy arises from two elements: the interest rate being lower than the Government's cost of borrowing capital and 'policy write-offs', for example, the fact that all loans are written off after 30 years.

The cost to the state of the loan system arises from the effective state subsidy of loans (e.g. the fact that loans are written off after 30 years) and costs arising from impaired loans. Each year, this impairment cost is accounted for in the budget deficit (as Department of Education expenditure). Based on economic simulations, it is estimated (conservatively) that the overall, full repayment rate on the loan book will be 82%.

This method of treating the student loans on the government balance sheet is based on the UK's Resource Accounting and Budgeting Charge (RAB) accounting method. The RAB is the estimated default and loan impairment rate. The government would provide an allocation in its annual budget to cover the RAB charge on student loans. This would count towards current budget expenditure (from DES).

Interest Payments on government borrowings also count as current expenditure in the budget.

Therefore the annual current cost of the loan system is the Expected Cost of Impaired Loans (assumed to be 18 per cent of annual loans) plus the cost of interest repayments (assumed to be 2 per cent).

In the first year the estimated public borrowing requirement is be €75 million, the cost of impaired loans is €13.5 million and the cost of interest repayments is €1.5 million, making a current expenditure cost of €15.5. This would peak in 2020 at €58 million.

## **Notes on Assumptions Made in Costing Income Contingent Loan System**

### **1. Average Cost of University**

Student Fee Contribution will increase from 2750 to 3000 in 2015/2016

Monthly Maintenance Expense is from Irish League of Credit Unions 'Cost of Third Level Education' Survey' (August 2014)<sup>2</sup>

79% of parents supporting their children financially through college, contributing €428 per month per child to cover costs of college

44% of students now living away from home compared to 32% in 2013, paying average of €346 in rent

Estimated Annual cost of third level as  $428 \times 9 + 3000 = €6,852$ .

### **2. Eligibility for Loans**

All undergraduates and apprentices undertaking a post-primary course in university, college or institute of technology including those in receipt of Student Support Grant (maintenance grant or student contribution fee grant).

### **3. Take-up rates of Loans**

We assumed the Following take up rates of loans:

30% of postgraduate students

40% of students not in receipt of any student grant support ('Free Fees Students')

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<sup>2</sup> ILCU 2014. '3rd Level Education Costs Survey & What's Left Tracker'. Available [here](#).



20% of Students in Receipt of Part (25%) Maintenance Grant Rate @ €1515

20% of Students in Receipt of Part (50%) Maintenance Grant Rate @ €2270

10% of Students in Receipt of Full Maintenance Grant Rate @ €3025

0% of Students in Receipt of Special Rate @ €5915

These take-up rates also apply to students in receipt of non-adjacent rate grants

#### **4. Estimated Loan Requirement for (Additional) Maintenance, among students with various grant eligibility profile**

We subtracted the maintenance already received by students to estimate the level of loan that would be required by students.

Example 1: those in receipt of a full maintenance grant of €3,025 have a cost of maintenance of €428 for 9 months of the year and do not pay any student contribution, so their estimated loan requirement for one year is

$$3025 - (428*9) = €827$$

Example 2: those in receipt of a student contribution grant but no maintenance support have a cost of maintenance of €428 for 9 months of the year and do not pay any student contribution so their estimated loan requirement for one year is just their cost of maintenance

$$428*9 = €3852$$

Example 3: those not in receipt of any student grant have full cost of maintenance plus full cost of tuition (student contribution)

$$3000 + (428*9) = €6852$$

#### **5. Average Loan**

This is the average of the estimated required loans (above) weighted by the relative size of the group to overall student population.

## 6. State Total Outlay Year 1

Assumed loan at each category of student maintenance grant eligibility by Number of Students assumed to take up a loan in each eligibility category.

## 7. Assumed Full Repayment Rate on all student loans

It is assumed that 82 per cent of loans would be paid back in full and 18 per cent of loans would be impaired (i.e either not paid back at all or partially paid back).

This assumption is based on a simulation of Life Time Earnings of graduates in Ireland by Flannery and Donoghue (2011)<sup>3</sup>:

‘For the ICL [Income Contingent Loan] system simulated...83 per cent of graduates pay back their loan in full when a zero real interest rate is applied to the debt.’<sup>4</sup>

Based on this simulation, Flannery and O’Donoghue found that: ‘Males that do pay off their debt in full do so in an average of 13 years when the assumption of a zero real interest rate is applied, while females take 15 years on average.’<sup>5</sup>

They made following assumptions<sup>6</sup> about how any income contingent student loan system would operate in Ireland:

- individuals were assumed to have completed 4 years of full time tertiary education between the ages of 19 and 22 inclusive, and in the context of an ICL system to have received, during each of those years’ loans of €2,500 per annum (in 2000 prices)
- therefore, each graduate is assumed to incur a debt of €10,000 by the end of his/her stay in higher education
- payment begins as soon as they graduate, with no grace period.
- there is no initial interest rate on the loan until graduation, but the principle is scaled every year by the increase in inflation, in other words there is a zero real interest rate attached to the loan.
- there is no scope for early repayment in the system and there is no system for tracking emigrants

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<sup>3</sup> Flannery, D. & O’Donoghue, C. 2011. The Life-Cycle Impact of Alternative Higher Education Finance Systems in Ireland. *The Economic and Social Review*, Vol. 42, No. 3. Available [here](#).

<sup>4</sup> Ibid, pp.252-253.

<sup>5</sup> Ibid, pp.253-254.

<sup>6</sup> Ibid, pp. 249-252.

- the income threshold is set as the average income of those working for pay in our population for any given year
- any individual whose taxable income is below this threshold in a given year does not have to repay any amount in that year
- this suggests an equitable income threshold as any graduate above this level can be said to be gaining some premium from higher education in the form of higher earnings
- individuals will pay 10% of any income earned above this threshold to service their loan

### 8. Assumed Partial Repayment Rate

We assumed that 10% of loan recipients will not pay off any debt whatsoever and assumed that 3% of recipients will pay off 70% of their debt

### 9. Loan Tranche Repayment Schedule

50% of graduates from 2013 earned between 25,000 and 45,000 in their first year after graduation

Earnings in First Year After Graduation - Class of 2013\*

Level of Qualification	<€25,000		€25,000 - €45,000		>€45,000	
	2013	2012	2013	2012	2013	2012
Honours Bachelor Degree	52%	56%	45%	42%	3%	2%

\*HEA Final Destination Report 2014

Graduates undertaking three-year courses starting in 2017 will become liable to start making repayments in Oct. 2020. Based on above, if repayment threshold was €30,000, a rough guess is that about 25% of graduates would be in a position to make a repayment in the first year.

Public debt (in real, discounted terms) would increase until the additional loans made to students on courses that last longer than three years are greater than the early repayments made by graduates – but from then on the repayments received result in a reduction in the outstanding public debt.

This would probably mean that public debt would increase until the point that the graduate cohort of 2020 began to resemble the general income distribution (there is no data on this as the Final Destination Reports only ask graduates about earnings in first year after graduation; we believe a close guess might be 5 years.)

Total annual repayments by graduates increase as graduate earnings increase, but peak as high-earning graduates reach the point of having paid off their loans and cease making repayments.

For small number graduates earning €35,000 upon graduation, this would mean the peak would be about 10 years.

By about 2042, all repayments from the cohort of students that entered university in 2016 will have ceased as graduates reach the end of the repayment period. This is based on the idea that if those earning €30,000 being repaying 5 years after graduation, it will take 17 years to clear loans fully.

Type of student according to Degree Level & Student Support Status	Level of Maintenance Grant Rate	Total No Students in Each Eligibility Profile	Total Grant Students	%Students at Different Maintenance Grant Tresholds	New Entrants 2017 in Each Grant/Non-Grant Category	Estimated Loan Requirement for (Additional) Maintenance, among students with various grant eligibility profile (€)	Assumed Take-Up Rates	Students Taking a Loan Year 1	Estimated Outlay Year 1
Special rate	5,915	10,051	57,767	0.17	2,044	- 2,063	0.00	-	-
Full Maintenance	3,025	15,360		0.27	3,124	827	0.10	312	258,378
Part maintenance (75%)	2,270	500		0.01	102	1,582	0.20	20	32,178
Part maintenance (50%)	1,515	1,073		0.02	367	2,337	0.20	73	171,378
Part maintenance (25%)	755	1,010		0.02	345	3,097	0.20	69	213,776
Special rate NonAdj	2,375	9,424		0.16	3,220	1,477	0.00	-	-
Full Maintenance NonAdj	1,215	17,373		0.30	5,937	2,637	0.10	594	1,565,497
Part maintenance (75%) NonAdj	910	636		0.01	217	2,942	0.20	43	127,878
Part maintenance (50%) NonAdj	605	1,215		0.02	415	3,247	0.20	83	269,622
Part maintenance (25%) NonAdj	305	1,125		0.02	384	3,547	0.20	77	272,716
Free Fees Undergraduates	-	90,787		0.00	22,260	6,852	0.40	8,904	61,010,208
Postgraduates	-	37,516		0.00	3,704	10,000	0.30	1,111	11,112,000
<b>Average Loan (population weighted)</b>						<b>6,339</b>		<b>Total Students Taking Loan Yr 1</b>	<b>Total Outlay Yr 1 (€, millions)</b>
<b>Three Year Undergrad Average Loan</b>						<b>19,018</b>		<b>11,287</b>	<b>75</b>

<b>Effect on Budget Balance Sheet (€, millions)</b>	<b>2017</b>	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>
<b>Gross Public Sector Borrowing Requirement</b>	75	124	199	274	349
<b>Annual Cost of Impaired Loans</b>	13.5	27	41	53	35
<b>State Interest Repayment</b>	1.5	2	4	5	7
<b>Net Public Sector Borrowing Requirement</b>	75	124	157	214	301
<b>Annual Deficit Expense (Current Budget Expenditure)</b>	15.0	29	45	58	42
<b>Total Current Expenditure Expense 2017-2021 (€, millions)</b>					<b>189</b>