CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

Revised March 19, 2007

H.R. 5
College Student Relief Act of 2007

As passed by the House of Representatives on January 17, 2007

SUMMARY

H.R. 5 would amend the Higher Education Act of 1965 and make several changes related to the federal student loan programs. The act would reduce certain interest rates, reduce payments to lenders, increase fees on lenders, and reduce the share of default collections retained by nonfederal guaranty agencies. The Congressional Budget Office estimates that those changes would reduce direct spending by $2.6 billion over the 2007-2012 period and by $10.6 billion over the 2007-2017 period.

H.R. 5 contains no intergovernmental or private-sector mandates as defined by the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COSTS TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 5 is presented in the following table. The cost of this legislation falls within budget function 500 (education, training, employment, and social services).

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 5 will be enacted before July 1, 2007.

	Millions of Dollars, by Fiscal Year												
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017-2012	2007-2017
CHANGES IN DIRECT SPENDING [a]													
Interest Rate Reductions													
Estimated Budget Authority	335	930	1,535	2,195	2,850	635	--	--	--	--	--	8,480	8,480
Estimated Outlays	195	640	1,170	1,735	2,305	1,410	--	--	--	--	--	7,455	7,455
Reductions in Lender Insurance													
Estimated Budget Authority	-1,350	-265	-280	-295	-310	-325	-340	-350	-360	-375	-390	-2,825	-4,640
Estimated Outlays	-1,345	-150	-235	-255	-265	-275	-285	-295	-310	-325	-335	-2,525	-4,075
Retention of Guaranty Agency Collections													
Estimated Budget Authority	-1,145	-150	-155	-165	-170	-175	-185	-195	-200	-205	-215	-1,960	-2,960
Estimated Outlays	-1,145	-85	-135	-140	-145	-150	-160	-165	-170	-175	-180	-1,800	-2,650
Reduction in Special Allow-ance Payments to Lenders													
Estimated Budget Authority	-680	-445	-470	-490	-515	-540	-560	-585	-610	-635	-665	-3,140	-6,195
Estimated Outlays	-585	-315	-395	-415	-435	-455	-475	-495	-515	-535	-560	-2,600	-5,180
Increased Loan Fees from Lenders													
Estimated Budget Authority	-580	-435	-460	-485	-510	-535	-560	-580	-605	-635	-660	-3,005	-6,045
Estimated Outlays	-485	-310	-390	-410	-430	-455	-475	-495	-515	-535	-560	-2,480	-5,060
Interest Payment Rebate Fee													
Estimated Budget Authority	-300	-80	-85	-85	-90	-95	-105	-105	-110	-115	-125	-735	-1,295
Estimated Outlays	-265	-65	-70	-75	-80	-80	-85	-90	-95	-100	-105	-635	-1,110
Interactions Among All Program Changes Listed Above													
Estimated Budget Authority	5	5	0	-5	-5	0	10	0	-5	-5	5	0	5
Estimated Outlays	0	-5	0	0	5	-5	5	0	5	0	0	-5	5
Total Changes													
Estimated Budget Authority	-3,715	-440	85	670	1,250	-1,035	-1,740	-1,815	-1,890	-1,970	-2,050	-3,185	-12,650
Estimated Outlays	-3,630	-290	-55	440	955	-10	-1,475	-1,540	-1,600	-1,670	-1,740	-2,590	-10,615

a. Estimates relative to CBO's March 2007 baseline projections.

As required under the Federal Credit Reform Act of 1990, the costs of student loans are estimated on a net-present-value basis rather than the cash basis used for most other federal programs. H.R. 5 would affect such credit reform estimates in several ways: by reducing interest rates charged on student loans, by reducing certain payments to private lenders of federally guaranteed loans, and by increasing certain fees paid to the government by such lenders.

Interest Rate Reductions

Under current law, the interest rate charged borrowers for both subsidized and unsubsidized student loans is 6.8 percent for loans disbursed after June 30, 2006. Section 2 of H.R. 5 would reduce the rate for subsidized loans in stages: for successive 12-month periods beginning in July 2007, the rates would be 6.12 percent, 5.44 percent, 4.76 percent, and 4.08 percent, respectively. For the July 2011-December 2011 period, the rate would be 3.4 percent. Beginning in January 2012, the rate would revert back to the 6.8 percent rate prescribed in current law. CBO estimates that $7.5 billion in additional subsidy costs would result over the 2007-2012 period.

For guaranteed student loans, private lenders are paid interest based on a formula; if that rate exceeds what the borrower pays, the federal government is responsible for paying the difference between the two rates. When the lender formula produces a lower rate than the borrower pays, the lender must return the difference to the government. Consequently, any reduction in the borrower interest rate increases federal costs by increasing the payments made to lenders or by reducing the rebate lenders pay to the government. In the direct student loan program, the interest rate reductions always reduce federal receipts.

Reductions in Lender Insurance

The act would reduce the percentages that lenders receive when borrowers default on their loans in two ways: lowering the insurance rate from 97 percent of unpaid principal to 95 percent and eliminating the differential treatment (99 percent insurance) accorded to lenders defined as exceptional performers. CBO estimates that those changes would reduce outlays by $2.5 billion over the 2007-2012 period and by $4.1 billion over the 2007-2017 period.

The reduction in the lender insurance rate would apply for loans disbursed after June 2007, including new consolidation loans. CBO estimates the two-point reduction in the insured percentage would save $0.2 billion over the 2007-2017 period.

Under current law, exceptional performers are insured at 99 percent rather than 97 percent. Based on recent information from the Department of Education, CBO estimates that, in any given year, about 90 percent of outstanding principal is held by lenders with that designation. The combination of sections 3 and 5 of H.R. 5 would reduce the insurance rate for those lenders from 99 percent to 95 percent. CBO estimates that the reduction for those lenders would save about $3.9 billion over the 2007-2017 period.

Retention of Guaranty Agency Collections

Under current law, nonfederal guaranty agencies are allowed to retain 23 percent of their collections on defaulted loans. H.R. 5 would reduce that percentage over time to 20 percent for fiscal year 2008, 18 percent for fiscal years 2009 and 2010, and a rate—beginning in fiscal year 2011—that the Secretary of Education determines equals the average rate paid to collection agencies that have contracts with the Secretary. CBO estimates that reducing the retention rates would save $1.8 billion over the 2007-2012 period and $2.65 billion over the 2007-2017 period.

Based on its analysis of a similar proposal in the President's budget request for fiscal year 2007 and more recent information from the Department of Education, CBO estimates that the Secretary would determine a retention allowance rate of about 16 percent for fiscal years 2011 and beyond. That change would reduce the collections retained by 30 percent relative to current law.

Reduction of Special Allowance Payments to Lenders

Under current law, private lenders receive payments from the government when the interest rate formula used to pay lenders would provide an interest rate higher than that which would apply to borrowers. Such payments are referred to as special allowance payments. The specific lender formulas are based on the 91-day commercial paper rate plus: 1.74 percent for loans when borrowers are in school, in the six-month grace period after leaving school, or in a deferment period (for example, for economic hardship); 2.34 percent when the borrower is repaying the loan; and 2.64 percent when the borrower has consolidated the loan or the borrower is a parent. H.R. 5 would lower those "add-ons" by 10 basis points or 0.1 percentage points, except for those loans held by lenders in the bottom 10 percent of lenders ranked by volume.

Based on total new loan volume in the guaranteed loan program that CBO projects will rise from nearly $58 billion in 2008 to $86 billion by 2017, CBO estimates that the reduced special allowance payments would lower federal spending by $2.6 billion over the 2007-2012 period and $5.2 billion over the 2007-2017 period.

Increased Loan Fees From Lenders

Under current law, lenders pay the federal government 0.5 percent on each new loan (including consolidations). H.R. 5 would raise this fee to 1.0 percent. Based on its projections of loans to be disbursed over the projection period, CBO estimates that the increased fee would lower federal costs by $2.5 billion over the 2007-2012 period and $5.1 billion over the 2007-2017 period.

Interest Payment Rebate Fee

Section 8 of the act would increase the loan fee charged to lenders who hold consolidation loans. Under current law, lenders are required to pay the federal government 1.05 percent on the outstanding principal of the consolidation loans they hold. This provision would increase that fee to 1.30 percent for those lenders with consolidation loans comprising at least 90 percent of their total federal student and parent loan portfolio.

Based on the most recent data from the Department of Education on the concentration of consolidation loans among lenders and CBO's forecast of future consolidations, CBO estimates that the affected lenders would typically hold about 20 percent of all consolidation loans. CBO estimates that charging the additional fee would lower federal loan costs by $635 million over the 2007-2012 period and $1.1 billion over the 2007-2017 period.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 5 contains no intergovernmental or private-sector mandates as defined by UMRA and would impose no costs on state, local, or tribal governments.

PREVIOUS CBO ESTIMATE

On January 16, 2007, CBO transmitted a cost estimate for H.R. 5, as introduced on January 12, 2007. That cost estimate concluded that the legislation would reduce direct spending by $65 million over the 2007-2012 period and by $7.1 billion over the 2007-2017 period. Those amounts were relative to the CBO baseline projections completed earlier this winter (and published in January).

The revised estimates stem from new information from the Department of Education and from technical changes in CBO's March 2007 baseline. The largest difference is for the provision that would reduce lender insurance. Higher savings would accrue because revised data indicate that outstanding loan volume is higher than previously thought, and a much larger share of volume is held by "exceptional lenders" than the previous data indicated. (Exceptional lenders are lenders that meet or exceed certain standards for converting guaranteed loans to repayment, collecting delinquent loans, and filing claims with the guaranty agency in a timely manner.)

In addition, the estimated savings from reductions in the retention allowance on guaranty agency collections are larger because the most recent data show the agencies are collecting on a significantly larger base of defaulted loans than CBO had previously estimated. The largest change as a percentage of the earlier cost estimate is in the estimate for the increased consolidation fee charged to lenders for whom consolidation loans represent more than 90 percent of their total holdings of student loans. Recent data, which include the surge in consolidation loans in 2005 and 2006, indicate that a much greater portion of consolidation loans are held by those lenders.

Other technical factors that were changed for the March 2007 baseline include longer periods for which loans remain outstanding (longer lengths of time borrowers are in school or in deferment, as well as lower default rates) and slightly higher future consolidation rates. Finally, CBO boosted its projections of subsidized loan volume slightly over the 2008-20017 period.

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