CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 16, 2005

H.R. 609
College Access and Opportunities Act of 2005

As ordered reported by the House Committee on Education and the Workforce on July 25, 2005

SUMMARY

H.R. 609 would make numerous changes to federal higher education programs, including the student and parent loan programs. CBO projects that, under the current-law baseline, the loan programs would guarantee or disburse loans totaling about $360 billion over the 2006-2010 period—costing about $37 billion in total spending (mostly measured as subsidy costs). CBO estimates that enacting H.R. 609 would reduce these costs by $6.3 billion in 2006, $8.7 billion over the 2006-2010 period, and $4.5 billion over the 2006-2015 period. H.R. 609 also would affect spending subject to appropriation, but CBO has not completed an analysis of the bill's potential impact on discretionary spending.

Provisions of H.R. 609 with significant budget effects include:

- Change the formulas used to calculate borrower interest rates and lender yields;
- Eliminate the separate formula for lender yields for loans supported with certain tax-exempt funding;
- Change the insurance provided to lenders;
- Change the funding for mandatory administrative costs;
- Reduce borrower origination fees and mandate collection of a 1.0 percent insurance premium;
- Increase loan limits for first-year, second-year, and graduate students; and
- Delay the recall of the federal share of the Perkins Loan Revolving Fund.

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting H.R. 609 would cause an increase in direct spending greater than $5 billion in the 10-year period between 2016 and 2025. CBO also expects that the direct spending costs of the bill would exceed the $5 billion threshold in at least one of the 10-year periods from 2026 through 2055.

H.R. 609 contains no intergovernmental or private-sector mandates as defined by the Unfunded Mandates Reform Act (UMRA); any costs to state, local, or tribal governments would result from complying with conditions of federal assistance.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated impact of H.R. 609 on direct spending is shown in the following table. The costs of this legislation would fall within budget function 500 (education, training, and social services).

BASIS OF ESTIMATE

This estimate of the direct spending effects of H.R. 609 assumes that the bill will be enacted in the fall of 2005. The CBO has not completed its review of the provisions of the bill that would affect spending subject to appropriation.

Major Provisions Reducing Spending

The provisions of H.R. 609 that would generate the largest savings include changes to the borrower interest rate and lender-yield formulas, reductions in the federal insurance rates for lenders, and modifications in the budget authority provided for mandatory administrative expenses. Together these provisions would reduce outlays by $6.3 billion in 2006, $12.4 billion over the 2006-2010 period, and $20.1 billion over the 2006-2015 period. Because the changes would be made in federal loan programs, the impacts generally are the estimated changes in the subsidy costs that are assessed on a net present value basis, as specified in the Federal Credit Reform Act.

	By Fiscal Year, in Millions of Dollars									
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
CHANGES IN DIRECT SPENDING										
Major Provisions Reducing Spending:										
Changes in Borrower Interest Rates and Lender Yields										
Estimated Budget Authority	-5,495	-1,290	-1,190	-1,135	-1,145	-1,165	-1,195	-1,220	-1,245	-1,275
Estimated Outlays	-5,040	-1,080	-1,075	-1,005	-1,005	-1,015	-1,035	-1,065	-1,085	-1,110
Changes to Certain Loans Financed with Tax-Exempt Bonds										
Estimated Budget Authority	-980	-265	-265	-270	-270	-275	-280	-290	-290	-290
Estimated Outlays	-850	-235	-235	-235	-240	-245	-245	-250	-255	-265
Changes in Lender Insurance										
Estimated Budget Authority	-425	-145	-150	-160	-165	-170	-180	-185	-195	-200
Estimated Outlays	-385	-115	-130	-140	-145	-150	-155	-160	-170	-175
Changes in Mandatory Administrative Costs										
Estimated Budget Authority	-13	-128	-66	-187	-214	-241	0	0	0	0
Estimated Outlays	17	-111	-50	-172	-198	-225	-81	-21	-8	0
Subtotal										
Estimated Budget Authority	-6,913	-1,828	-1,671	-1752	-1,794	-1,851	-1,655	-1,695	-1,730	-1,765
Estimated Outlays	-6,258	-1,541	-1,490	-1552	-1,588	-1,635	-1,516	-1,496	-1,518	-1,550
Major Provisions Increasing Spending:										
Changes in Borrower Origination Fees and Insurance Premiums										
Estimated Budget Authority	10	265	685	1,045	1,420	1,590	1,610	1,625	1,635	1,660
Estimated Outlays	-90	70	450	750	1,070	1,275	1,335	1,345	1,350	1,360
Increase Loan Limits										
Estimated Budget Authority	0	315	540	555	580	600	620	640	660	685
Estimated Outlays	0	185	410	485	505	525	540	560	580	595
Changes in the Perkins Loan Program										
Estimated Budget Authority	40	40	40	40	40	40	401	715	736	840
Estimated Outlays	0	40	40	40	40	40	401	715	736	840
Subtotal										
Estimated Budget Authority	50	620	1,265	1,640	2,040	2,230	2,631	2,980	3,031	3,185
Estimated Outlays	-90	295	900	1,275	1,615	1,840	2,276	2,620	2,666	2,795
Other Provisions With Measurable Effects										
Estimated Budget Authority	245	76	33	38	53	66	66	71	66	76
Estimated Outlays	192	81	58	33	53	66	71	71	71	76
Interaction Effects										
Estimated Budget Authority	-132	-163	-182	-161	-154	-145	-137	-146	-137	-146
Estimated Outlays	-104	-100	-163	-141	-130	-121	-131	-135	-129	-126
Total Changes in Direct Spending										
Estimated Budget Authority	-6,750	-1,295	-555	-235	145	300	905	1,210	1,230	1,350
Estimated Outlays	-6,260	-1,265	-695	-385	-50	150	700	1,060	1,090	1,195

Borrower Interest Rate and Lender-Yield Formulas. Relative to the current-law baseline, H.R. 609 would change many of the formulas used to compute what borrowers owe to lenders and what lenders can charge. The following table outlines the current-law formulas and the proposed changes. Borrower rates on new Stafford and parent loans are scheduled to switch from a variable-rate formula to a fixed rate (6.8 percent for students and 7.9 percent for parents) in July 2006; H.R. 609 would eliminate that change and continue the current variable-rate formulas. The rates on consolidated loans would change from being a fixed rate based on the weighted average of the loans being consolidated, rounded up to the nearest one-eighth percent, to the borrower's choice of a variable rate (91-day Treasury bill rate plus 2.3 percentage points for students and plus 3.1 percentage points for parents) or a fixed rate (set at the 91-day Treasury bill rate plus 3.3 percentage points for students and plus 4.1 percentage points for parents). The rates for students and for parents would be capped at 8.25 percent and 9.0 percent, respectively.

The lender-yield formulas for student and parent loans would continue to be based on a variable-rate formula, but H.R. 609 would no longer allow the borrowers' rates to serve as the minimum for the lender yield. Lenders under current law receive the higher of the lender-yield formula or the rate paid by borrowers, but the bill would require lenders to rebate the difference between the two rates to the government when the borrower rate is higher.

The combination of these changes to borrowers and lenders would save $5.0 billion in 2006, $9.2 billion over the 2006-2010 period, and $14.5 billion through 2015.

Another change in the payment formulas for lenders affects loans that are funded with financing based on tax-exempt bonds issued between 1980 and 1993. Historically, these loans have had a different formula for determining payments to lenders. Specifically, the formula for the special allowance payments to the holders of these loans was 50 percent of the sum of the 91-day Treasury bill rate plus 3.5 percentage points or 9.5 percent, whichever was higher. In recent years, the 9.5 percent rate was higher. (Consequently, these have come to be referred to as 9.5 percent loans.) Legislation in 2004 modified this policy for most new loans from tax-exempt lenders during the October 2004 to December 2005 period, changing the lender formula to conform to the rates paid to other lenders. Under current law, the formula on new loans will revert back to the pre-October 2004 structure. H.R. 609 would continue the practice in place on December 2005, but expand its scope to include all new loans supported with this type of financing. This policy would save an estimated $850 million in 2006, $1.8 billion over the 2006-2010 period, and $3.1 billion over the 2006-2015 period.

Type of Loan	Loans originating after December 1999 and before July 2006	Loans originating after June 2006 (current law)	Loans originating after June 2006 (under H.R. 609)
BORROWER INTEREST RATES			
Student loans			
In-school, grace, or deferment	Variable rate set annually at 91-day Treasury bill plus 1.7 percentage points (8.25 percent cap)	Fixed rate at 6.8 percent	Variable rate set annually at 91-day Treasury bill plus 1.7 percentage points (8.25 percent cap)
In repayment	Variable rate set annually at 91-day Treasury bill plus 2.3 percentage points (8.25 percent cap)	Fixed rate at 6.8 percent	Variable rate set annually at 91-day Treasury bill plus 2.3 percentage points (8.25 percent cap)
Parent loans	Variable rate set annually at the Treasury bill rate plus 3.1 percent (9.0 percent cap)	Fixed rate at 7.9 percent	Variable rate set annually at 91-day Treasury bill rate plus 3.1 percent (9.0 percent cap)
Consolidation loans			
Students	Fixed rate set at the weighted average of loans consolidated rounded up to nearest 1/8 percent	Fixed rate set at the weighted average of loans consolidated rounded up to nearest 1/8 percent	Choice of variable rate set annually at 91-day Treasury bill rate plus 2.3 percent (8.25 percent cap) or fixed rate set at 91-day Treasury bill rate plus 3.3 percentage points
Parents	Fixed rate set at the weighted average of loans consolidated rounded up to nearest 1/8 percent	Fixed rate set at the weighted average of loans consolidated rounded up to nearest 1/8 percent	Choice of variable rate set annually at 91-day Treasury bill rate plus 3.1 percent (9.0 percent cap) or fixed rate set at 91-day Treasury bill rate plus 4.1 percentage points

Continued

Continued

Type of Loan	Loans originating after December 1999 and before July 2006	Loans originating after June 2006 (current law)	Loans originating after June 2006 (under H.R. 609)
	LENDER YIELDS		
Student loans			
In-school, grace, and deferment	Greater of 3-month commercial paper rate plus 1.74 percentage points or the borrower rate	Greater of 3-month commercial paper rate plus 1.74 percentage points or the borrower rate	3-month commercial paper rate plus 1.74 percentage points
In-repayment	Greater of 3-month commercial paper rate plus 2.34 percentage points or the borrower rate	Greater of 3-month commercial paper rate plus 2.34 percentage points or the borrower rate	3-month commercial paper rate plus 2.34 percentage points
Parent Loans	Greater of 3-month commercial paper rate plus 2.64 percentage points only when the borrower rate is capped at 9.0 percent or the borrower rate	Greater of 3-month commercial paper rate plus 2.64 percentage points only when that formula exceeds 9.0 percent or the borrower rate	3-month commercial paper rate plus 2.64 percentage points
Consolidation loans			
Student loans	Regular formula less 1.05 percentage points	Regular formula less 1.05 percentage points	Regular formula less 1.05 percentage points
Parent loans	Regular formula less 1.05 percentage points	Regular formula less 1.05 percentage points	Regular formula less 1.05 percentage points

Federal Lender Insurance. H.R. 609 would reduce the portion of defaulted loans for which lenders are reimbursed. Under current law, lenders are generally reimbursed for 98 percent of the outstanding balances on loans which go into default. Lenders who meet certain requirements are classified as exceptional lenders and they receive 100 percent insurance. H.R. 609 would reduce the 98 percent to 96 percent, and would tighten eligibility for the exceptional lender designation. For those lenders losing exceptional lender status the insurance rate would drop from 100 percent to 96 percent. CBO estimates that these changes would reduce outlays by $385 million in 2006, $915 million over the 2006-2010 period, and $1.7 billion through 2015.

Changes to the federal reinsurance rate only affect intrabudgetary transactions, and have no effect on total federal spending or revenues.

Funding for Mandatory Administrative Costs. Under the Higher Education Act of 1965, section 458 specifies a direct appropriation for administrative costs associated with operating the financial assistance programs for post-secondary education students. After 2002, the statute does not contain a limit on the amount provided for those activities; thus, CBO treats this account as an uncapped direct spending program. CBO's baseline assumes that the portion of the account that funds administrative activities would be equal to the actual amount used in 2004, adjusted for anticipated inflation. The other major component is an account maintenance fee payable to guaranty agencies equal to 0.10 percent of original principal on outstanding guaranteed student loans.

H.R. 609 would establish new annual caps on total section 458 funds, and restrict the amount that could be used for the agency account maintenance fees below what the formula would provide. CBO assumes that the entire amount of the fees will be paid, but a portion would be paid out of the federal student loan reserve fund (the on-budget guaranty agency account referred to in the previous section) instead of out of section 458. As a result, the amounts that certain agencies would retain in the reserve fund would fall below that fund's minimum requirements and some of these agencies would have to collect the 1.0 percent insurance premium allowed guaranty agencies—premiums that many of those agencies currently waive. The net effect of these changes in section 458 funding would increase outlays by $17 million in 2006, but reduce them by $514 million over the 2006-2010 period and by $849 million over the 2006-2015 period.

Major Provisions Increasing Spending

The provisions in the bill that would result in the largest increases in spending are the changes to origination fees and insurance premiums paid by borrowers, increases in loan limits, and modifications to the Perkins Loan Revolving fund. The estimated costs resulting from these portions of H.R. 609 total $4.0 billion over the 2006-2010 period and $16.2 billion over the 2006-2015 period.

Borrower Origination Fees and Premiums. H.R. 609 would gradually reduce borrower origination fees for both subsidized and unsubsidized student loans, while at the same time requiring guaranty agencies to charge all guaranteed student and parent loan borrowers the 1.0 percent premium currently authorized. Currently, origination fees for guaranteed loans are 3.0 percent and the insurance premium is up to 1.0 percent. In the direct loan program, the origination fee is 3.0 percent (although the actual practice is to charge 1.5 percent up front and another 1.5 percent if the borrower fails to make timely payments) and there is no insurance fee. The changes in the bill would equalize the total fees charged to students borrowing through guaranteed loans with those borrowing through the direct loan program.

Total fees on student borrowers would drop to 2.5 percent in July 2007, to 2.0 percent in July 2008, to 1.5 percent in July 2009, and to 1.0 percent in July 2010. These changes would reduce outlays by $90 million in 2006 because the increased insurance premiums are recorded more quickly than the reduced origination fees (fees are tied to loan disbursements that often fall into a subsequent year). CBO estimates that the net impact of the changes would be to increase outlays by $2.25 billion over the 2006-2010 period and by $8.9 billion over the 2006-2015 period.

Borrower Loan Limits. H.R. 609 would increase the maximum amount of subsidized loans for first- and second-year students from $2,625 and $3,500, respectively, to $3,500 and $4,500 beginning in 2007. In addition, the bill would increase the limit for unsubsidized loans for each year of graduate school from $10,000 to 12,000. To conform the aggregate borrowing limits to the latter changes, the limit on unsubsidized loans would be increased by $10,000. These increases would boost aggregate student loan borrowing and increase spending by $1.6 billion over the 2007-2010 period and by $4.4 billion over the 2007-2015 period.

Perkins Loan Revolving Fund. H.R. 609 would divert certain default collections in the Perkins loan program to schools and delay the beginning of the recall to the Treasury of balances held by participating schools from 2012 to 2020.

Under current law, any collections by the Secretary of Education on defaulted Perkins loans—a program administered by colleges and universities—are returned to the Treasury. These collections amount to roughly $40 million per year. The bill would require the Secretary to reallocate these funds—in the following year—to other schools participating in the loan program, thus increasing net federal spending by $40 million annually beginning in 2007.

Beginning in 2012, schools are required to return the federal share of their Perkins loan repayments to the Treasury. H.R. 609 would delay that date until 2020. Based on data from the Department of Education, CBO estimates that the recall of the federal share would total about $2.5 billion over the 2012-2015 period. Consequently, the delay that would result from enacting H.R. 609 would reduce recoveries by a like amount.

Other Provisions With Measurable Effects

H.R. 609 contains numerous provisions that would have much smaller budgetary effects than those described above. Among them are changes in loan cancellation programs, borrower repayment terms, and interest deferment eligibility. Other provisions with some estimated budget effects during the 2006-2010 period include changes in the income protection allowance for dependent students, the restriction on eligibility for certain student with drug-related convictions, the eligibility of schools to participate on the basis of distance learning programs, and the multiple disbursement requirement for certain loans for schools with low default rates. The total effects of these provisions are costs of $192 million in 2006, $417 million over the 2006-2010 period, and $772 million for the 2006-2015 period.

Interactions

The overall spending reductions that H.R. 609 would yield are significantly larger than the sum of the individual provisions because many provisions interact. For example, the lender-yield and borrower interest rate changes save even more when the increased loan volume flowing from the changes in loans limits are considered. However those same loan limit increases boost the costs of the provisions that reduce borrower fees. As another example, the application of the proposed lender yields and borrower interest rates to the 9.5 percent loans increases the savings when compared to that provision alone. In total, the interactions among the various provisions generate an additional $104 million in savings in 2006, $638 million over the 2006-2010 period, and $1.3 billion over the 2006-2015 period.

ESTIMATED LONG-TERM EFFECTS ON DIRECT SPENDING

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget, Fiscal Year 2006), CBO estimates that enacting H.R. 609 would cause an increase in direct spending greater than $5 billion in the 10-year period between 2016 and 2025. CBO also expects that the direct spending costs of the bill would exceed the $5 billion threshold in at least one of the 10-year periods from 2026 through 2055.

INTERGOVERNMENTAL AND PRIVATE SECTOR IMPACT

H.R. 609 contains no intergovernmental or private-sector mandates as defined by UMRA. The bill would authorize funding for student aid and higher education programs, much of which would go to public institutions of higher education.

The bill also would impose several new reporting requirements on institutions of higher education that receive federal aid under Title IV of the Higher Education Act. These institutions would be required to submit data that would be used by the Department of Education to calculate an institution's affordability index. Institutions with indexes that exceed a certain threshold also would be required to submit management and action plans that outline steps the institution will take to reduce its affordability index. CBO assumes that these requirements are effectively placed on institutions participating in grant programs; therefore costs related to these provisions would be incurred voluntarily, as a condition of federal assistance.

ESTIMATE PREPARED BY:

Federal Spending: Deborah Kalcevic, Chad Chirico, and Justin Humphrey
Impact on State, Local, and Tribal Governments: Lisa Ramirez-Branum
Impact on the Private Sector: Nabeel Alsalam

ESTIMATE APPROVED BY:

Peter H. Fontaine
Deputy Assistant Director for Budget Analysis