Asset Management

News or Noise: Student Debt Tops $1 Trillion: Is an End to the Crisis in Sight?

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The students of the class of 2014 are leaving college owing more money than any class before them, with $33,000 in debt on average. Adjusted for inflation, that's almost double the amount that graduates borrowed two decades ago.[1] As a whole, student debt has surpassed the $1 trillion mark in the U.S. for the first time ever.[2] These debt levels negatively impact consumer spending and homeownership of recent college graduates and are a drag to the economy as a whole.

The government, which backs the majority of student loans, is also bearing the burden of increased debt; enrollment in government debt forgiveness programs has increased by almost 40% in the past six months alone.[3] While these figures are alarming, we are seeing parents, students and the government respond to check these tuition hikes, and evidence is mounting that if colleges do not innovate to respond to this new attitude toward student debt, they will suffer the financial consequences.

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The Move to MOOCs

One recent innovation in higher education is that students are increasingly choosing online courses over traditional in-person degrees, which helps to reduce their tuition costs, a trend we discussed in our 2012 white paper, "Higher Education: Challenges and Outlook." Since then, enrollment in and availability of online courses has continued to grow. Between 2002 and 2011, enrollment in online programs as a percentage of total college enrollment tripled from 10% to 30%.[4] Colleges have responded with increased offerings of online courses, including so-called massive open online courses, or MOOCs, which are usually free and aim to educate large numbers of students online.

The New York Times named 2012 the "Year of the MOOC," and since that year the number of available MOOCs has skyrocketed from about 100 to more than 1,200 courses at 200 universities, including distinguished institutions like Harvard and Yale.[5] While students can't typically receive college credit for these courses, the educational community is trying to adapt to this new approach to education and decide whether credit hours for MOOCs may be granted in the future. Georgia Tech has been an ambitious early adopter of granting credit for MOOCs. In 2013, the school announced that it would begin offering an online-only degree in computer science for only $7,000.

These developments are exciting, as they may help open the door to higher education to more Americans than ever. That's important in today's U.S. economy, where 60% of jobs require a postsecondary education, a figure that experts believe will increase in years to come.[6] For that reason, a college degree is still worth its cost in the long run. College graduates earn 84% more than high school graduates over a lifetime and enjoy lower unemployment rates.[7] Reduced costs could allow more students to reap these benefits.

The outlook isn't quite as rosy, though, for universities that offer high-tuition resort-like university educations. Small private U.S. colleges have been hardest hit, with many of these schools experiencing drops of over 10% in enrollment. The financial health of many institutions is suffering as a result, as seen by a recent increase in downgrades from credit rating agency Moody's. Of the 500 colleges and universities rated, Moody's has downgraded 28 schools on average each year between 2009 and 2013. That's more than double the number of schools downgraded per year in the five previous years. According to Moody's, 60% of the schools it tracks have expenses that are higher than their revenues. For schools that fail to adapt, the consequences could be dire. One Harvard Business School professor has even predicted that up to half of the 4,000 U.S. colleges and universities could fail by 2030.[8] As students shop around for the best education they can get for the lowest cost, schools must innovate to provide quality educations with fewer resources.

A New Rating System for Colleges?

The cost pressures for colleges and universities will increase if proposed government programs take effect. At the direction of President Obama, the U.S. Department of Education is developing a rating system that would evaluate schools based on tuition cost and student debt as well as earnings of graduates. These ratings would potentially allow the government to offer financial aid based on these factors, which could put downward pressure on tuitions. That could not only make schools more affordable for students, but it could also reduce government spending on financial aid and loan forgiveness.[9] It would also allow students a way to judge the potential return on investment of a degree from each institution. It can be difficult to discern the true value of an education based on the well-publicized rankings that rely on factors like faculty-to-student ratio, which implies an increased cost but not necessarily a better education.

Most of these trends are a continuation of those we saw developing in 2012. While college costs are still on the rise, evidence suggests that students and the government are continuing to pressure colleges and universities to become more cost-conscious, which is a good sign for the future of higher education. The potential failure of large numbers of institutions is concerning, but we would take it as evidence that the current cost trends are unsustainable, and students, who have borne the incredible tuition increases of the past several decades, are beginning to push back. The fact that many distinguished universities are responding with major innovations like MOOCs leaves us optimistic that we are on the cusp of major innovations in higher education that will allow the numbers of college-educated students in the U.S. to continue growing at the rate necessary to fuel our economy.

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What Is News or Noise?

Like most of you, we are inundated with information on our phones, in our email inboxes and on the Internet. Clearly, the world doesn’t need another investing blog to reprocess stale information or reformat the day’s useless headlines. Thus, in our investment blog, “News or Noise,” we’ve taken up the challenge of sorting through the infinite bits of background noise and seeking the few truly newsworthy nuggets of information. What are the stories today that are likely to be meaningful for investors in the future? A very small number of headlines are important and of those, many are immediately processed by investors. Only a tiny fraction of all the new data is truly relevant and underappreciated.