CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 18, 2004

H.R. 5186
Taxpayer-Teacher Protection Act of 2004

As cleared by the Congress on October 9, 2004

SUMMARY

H.R. 5186 would temporarily limit lender yields on federally guaranteed student loans made from the proceeds of tax-exempt bonds and would expand, on a limited basis, a current loan-forgiveness program for certain student borrowers who subsequently teach in elementary schools.

CBO estimates these changes to the Higher Education Act of 1965 (HEA) would decrease direct spending by $15 million in 2005 and by $19 million over the 2005-2009 period. They would have no significant impact for years after 2009.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 5186 is shown in the following table. The changes in direct spending fall within budget function 500 (education, training, employment, and social services).

BASIS OF ESTIMATE

The costs of the student loan programs are included in CBO's baseline, reflecting the assumption that the authorization for the existing loan programs is extended. Specifically, section 257 of the Balanced Budget and Emergency Deficit Control Act requires that certain expiring programs be assumed to continue for baseline projection purposes. The budgetary treatment of the student loan programs is governed by the requirements of the Federal Credit Reform Act of 1990. As such, the budget records the present value of all the costs and collections associated with a new loan as budget authority in the year the loan is obligated and as outlays when it is disbursed. The costs of all changes affecting outstanding loans are displayed in the fiscal year the bill is enacted.

	By Fiscal Year, in Millions of Dollars											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005-2009	2005-2014
CHANGES IN DIRECT SPENDING												
Lender Yields on Loans Made from the Proceeds of Tax-Exempt Bonds												
Estimated Budget Authority	-270	-15	0	0	0	0	0	0	0	0	-285	-285
Estimated Outlays	-190	-95	0	0	0	0	0	0	0	0	-285	-285
Teacher Loan Forgiveness												
Estimated Budget Authority	190	35	30	18	8	*	*	*	*	*	281	281
Estimated Outlays	175	35	30	18	8	*	*	*	*	*	266	266
Total Changes												
Estimated Budget Authority	-80	20	30	18	8	*	*	*	*	*	-4	-4
Estimated Outlays	-15	-60	30	18	8	*	*	*	*	*	-19	-19

Note: * = between -$500,000 and $500,000.

Lender Yields on Loans Made with the Proceeds of Tax-Exempt Bonds

Under current law, holders of federally guaranteed student loans receive a statutory rate of return, referred to as the lender yield. When the interest rate paid by borrowers is less than the lender yield, the government pays the holders the difference, which is known as the special allowance payment (SAP).

Some holders of guaranteed student loans are state agencies or state-designated authorities, which may issue tax-exempt bonds to raise capital to make or purchase student loans. Those bonds generally carry a lower interest rate than bonds that are not tax-exempt to the bond holders. Yields for loans supported by the tax-exempt funding were set statutorily at one-half the yield earned by other lenders of student loans but can be no less than 9.5 percent. (These loans are commonly referred to as "9.50 loans." In the different interest rate environment of the late 1970s and early 1980s, this formula was thought to be a means of limiting potentially excessive returns on those loans.)

In 1993, the HEA was amended. That change set the lender yield on loans financed by any *newly issued* tax-exempt bonds at the same rates that apply to all other holders of student loans.

Over the past decade, new student loans have continued to be made with these older tax-exempt bonds through three mechanisms:

- First, as loans are repaid, new loans can be made as long as the terms of the bond have not expired, a practice known as recycling.

- Second, agencies with the older tax-exempt bonds have been able, under current program guidelines, to replace the outstanding bonds with new issues without losing eligibility for the 9.5 percent lender yield. This practice, referred to as refunding, has allowed tax-exempt authorities to lower their interest costs, free more resources to make new loans, and extend their eligibility for the 9.5 percent yield.

- Third, as a result of rulings by the Department of Education during the early and mid-1990s, any loan originally made with the proceeds of a pre-1993 tax-exempt bond and subsequently refinanced by the state agency or authority with taxable bonds would retain the 9.5 percent minimum yield. This practice, often referred to as transferring, frees up resources to make new loans.

H.R. 5186 would limit, on a temporary basis, the guaranteed minimum yield for 9.50 loans that are refunded or transferred. Beginning on October 1, 2004, and ending before January 1, 2006, any new loan originated or newly purchased using the proceeds and revenues of the tax-exempt bonds issued between 1980 and 1993, if either the underlying bonds are refunded between the above dates or the loan is transferred, would have the same yield available to holders of other guaranteed student loans. In addition, any currently outstanding loan receiving the 9.5 percent yield would begin to receive the same lender yield as other guaranteed loans if the underlying tax-exempt bond is refunded, retired, or defeased between the above dates. Thus, for this period, additional 9.50 loans could only result from recycling.

The lender yield for those loans losing the 9.5 percent minimum yield would be based on the three-month commercial paper (CP) rate. For student loans, the lender yield would be the three-month CP plus 1.74 percent while the borrower is in school, during the first six months after leaving school, or during a period when repayments are deferred. While the borrower is repaying the loan, the lender yield would be the three-month commercial paper rate plus 2.34 percent or the borrower's interest rate, whichever is higher. The lender yield on parent and consolidation loans generally would be based on the three-month CP plus 2.64 percent.

During the 15 months this provision would be in effect, CBO estimates that approximately $2.7 billion in loans would lose the guaranteed 9.5 percent yield for the life of the loan. (Over the long term, the lender yield on most loans would probably decline to between 7 percent and 8 percent.) The vast majority of this reduction in 9.50 loans comes from limiting transfers. This change is estimated to save $190 million in 2005 and $95 million in 2006.

Teacher Loan Forgiveness

Under current law, all new student borrowers as of October 1998 who subsequently teach in elementary or secondary schools in a school district eligible for funds under title I of the Elementary and Secondary Education Act (ESEA) and in a school where more than 30 percent of the students come from low-income families are eligible to have the government pay off or cancel part of their outstanding subsidized or unsubsidized student loan debt. To qualify, teachers must teach full-time for five consecutive years, and then only if they are determined to be qualified by the chief administrative authority (in the case of elementary school teachers) or are teaching in an area relevant to their college major (in the case of secondary school teachers). If they meet those criteria, 100 percent of their outstanding debt is canceled up to a maximum of $5,000. CBO estimates that, under current law, the total federal costs for teacher loan forgiveness would be approximately $2.3 billion over the 2005-2014 period. Ultimately, about 75,000 teachers are expected to apply each year for the $5,000 in loan forgiveness.

New Restriction on Loan Forgiveness Participation. Under H.R. 5186, new teachers would have to be deemed "highly qualified" teachers as defined by the ESEA to receive the loan forgiveness described above. For elementary school teachers, this means that they would have to hold a bachelor’s degree and pass a rigorous state examination that tests skills and knowledge in teaching reading, writing, mathematics, and other required subjects. Middle school and high school teachers would have to hold a bachelor’s degree and pass a rigorous state exam for each academic subject they teach. Teachers who were teaching prior to enactment of H.R. 5186 and are eligible for the loan forgiveness under current law would be exempt from the new standards.

Existing federal education statutes already encourage states to move towards a highly qualified teaching force by academic year 2005-2006. As a result, the new restriction would likely affect relatively few teachers each year. Based on data from the National Center on Education Statistics (NCES), CBO estimates about 3,000 fewer teachers who were new student loan borrowers prior to October 1, 2005—about 4 percent—would be eligible each year for loan forgiveness as a result of this restriction. CBO estimates that this change would save $35 million in 2005 and negligible amounts in subsequent years.

Increase in Loan Forgiveness Amounts. H.R. 5186 also would increase the maximum amount of loan cancellation from $5,000 to $17,500 at the end of the fifth year of teaching for certain teachers who were new student loan borrowers prior to October 1, 2005. The increase in loan forgiveness would apply to highly qualified mathematics and science teachers and special education teachers who teach in schools that are currently eligible. CBO estimates this provision would increase outlays by $210 million in 2005 and $301 million over the 2005-2014 period (mostly between 2005 and 2009).

H.R. 5186 would not provide the additional benefits to any teacher who had not participated in the student loan programs before October 1, 2005. For those who have, the additional benefits would accrue only to a small portion of those eligible for loan forgiveness under current law. Based on data compiled from NCES, CBO estimates that mathematics, science, and special education teachers would represent approximately 13 percent of teachers at these schools.

At the program's peak, CBO estimates that under H.R. 5186 approximately 5,500 mathematics, science, and special education teachers would become eligible each year to receive loan forgiveness. (Few, if any, teachers would be eligible for the expanded benefits in 2005 because of the five-year teaching requirement.) The average loan forgiveness for these teachers would total roughly $16,000 once they complete the required five years of service.

In modeling the participation rate for various loan forgiveness alternatives for teachers, CBO used data from the Perkins loan program, for which loan forgiveness provisions have been in place for 25 years. To the extent that those data reflect the impact of loan forgiveness on teacher turnover rates, CBO has incorporated similar effects for teachers with federal direct or guaranteed student loans. Although different amounts of loan forgiveness may have marginally different effects on teacher retention, any such effects would likely be small relative to the overall budgetary costs.

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