Assessing the Student Loan Scheme:
the cost and value of lending

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Key facts

- In 2005, each dollar lent under the NZ student loan scheme cost the government 11 cents
- In 2007, the figure was 41 cents
- In 2011, it was 45 cents
- What can have happened?

This presentation

- Why we have loans and how we value them
- Some questions about the cost of loans
  - What is the cost made up of?
  - What drives the cost?
  - What will happen over the long term?
- How we compare
- What are we doing about the cost of student loans?

Why we have loans in NZ: policy goals

Student loans were introduced in 1992 to:

- Reflect that there was no private credit market for student loans
- Share costs and risks between government and students/families:
  - Government can support wider access if it shares costs – and has done so
  - More students can afford to meet upfront costs of study
  - Income-contingent design shares risk as well as cost
- Enable students to meet fees and provide resourcing to education providers through their students' demand for education
- Complement existing tuition subsidies and targeted student allowances with a near-universal loan system

How we are doing

- Higher participation in tertiary education: places have doubled and participation rates up from 10.7% to 14.8%. 74% of eligible students borrow
- Costs are shared: students pay around 27% of total cost (before loan subsidies), up from 12%
- Government subsidises loans significantly: 45 cents in each dollar is a cost to the Crown.
- Repayment times are moderate: median of 5.2 years for 2006 leavers who remain in New Zealand
- Repayment compliance is over 90%, for those who remain in New Zealand

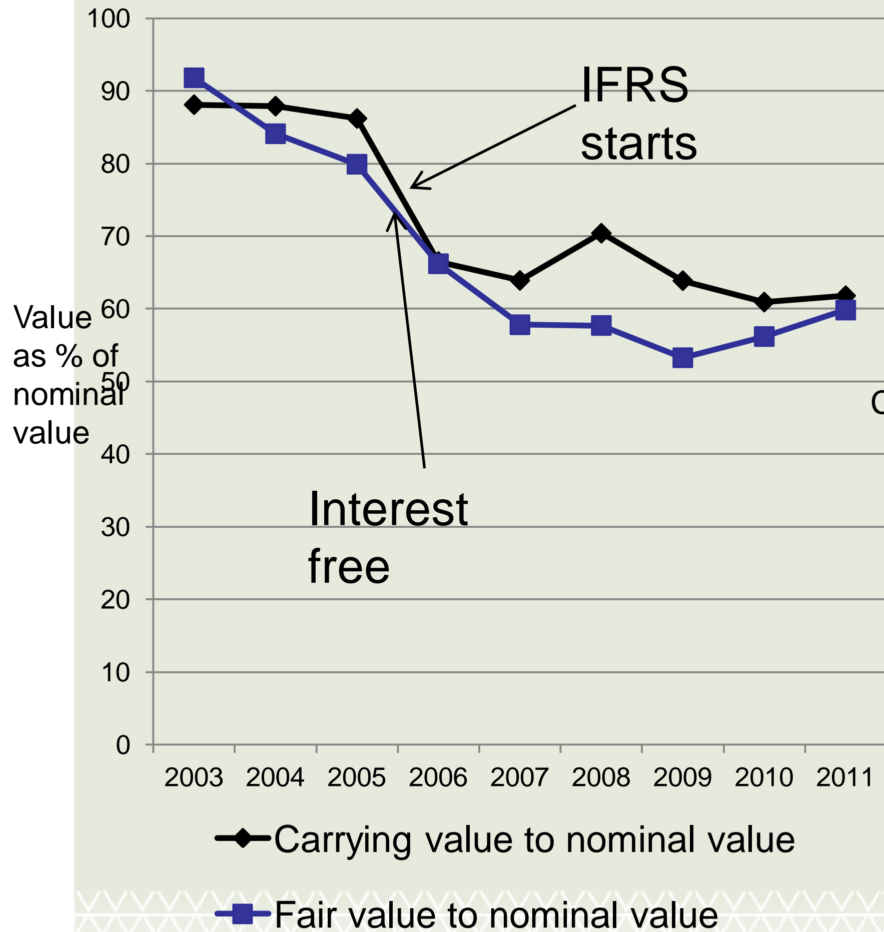
How student loans are valued

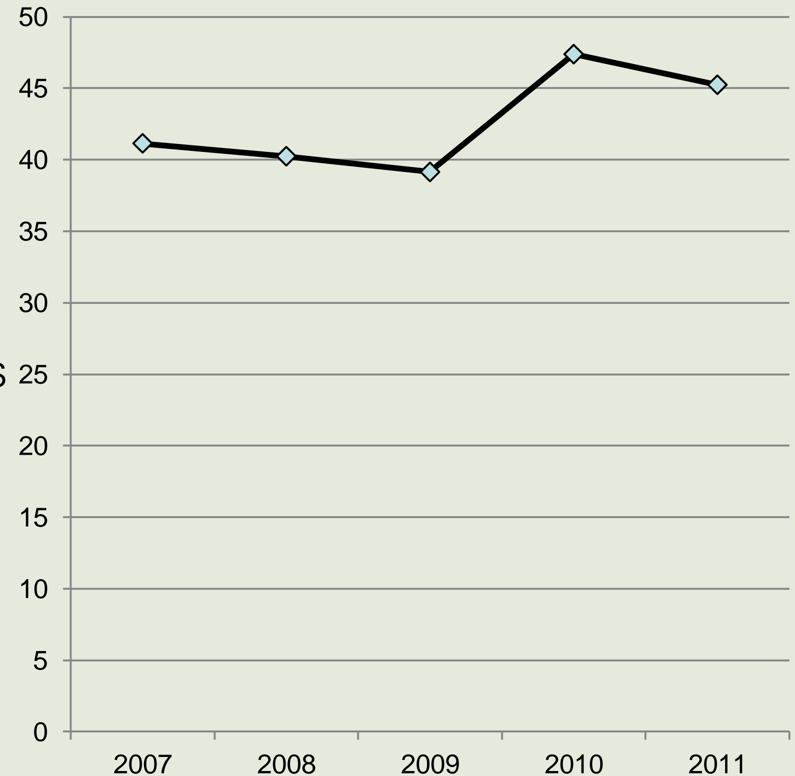
- Student loans are a large and growing financial asset – larger than the hospital network, and taking 10% of new capital spending
- Accounting principles mean any asset is valued at its market value (fair value) and as a going concern for its owner (carrying value)
- Accounting valuations also provide performance and management information. The focus is on the financial impacts of decisions.
- Our methods have improved in the past 20 years as information on loans has grown:
  - 1992-2003 – ‘doubtful debt provision’ calculated by agencies, between 10-15 cents in the dollar
  - 2004-2006 – actuaries calculate fair value, first estimated at 84% of nominal value
  - 2006-now – actuaries value the scheme based on International Financial Reporting Standards

Current approach to valuation

- Since 2006 under IFRS, lending is recorded at its 'fair value' at the point of lending – the same discount rate is used through the life of each loan
  - This is the 'initial fair value write-down'
- Each year actuaries revalue the asset, modelling expected future cash flows
  - using the latest income and repayment data
  - updated behavioural and economic assumptions
- A reduction in value is called an impairment and is treated as an expense
- The initial fair value write-down (IFVWD) is the *cost of new lending*

Trend in value and in the cost of lending





Note: fair value is equivalent to market value; carrying value is the value to current owner.

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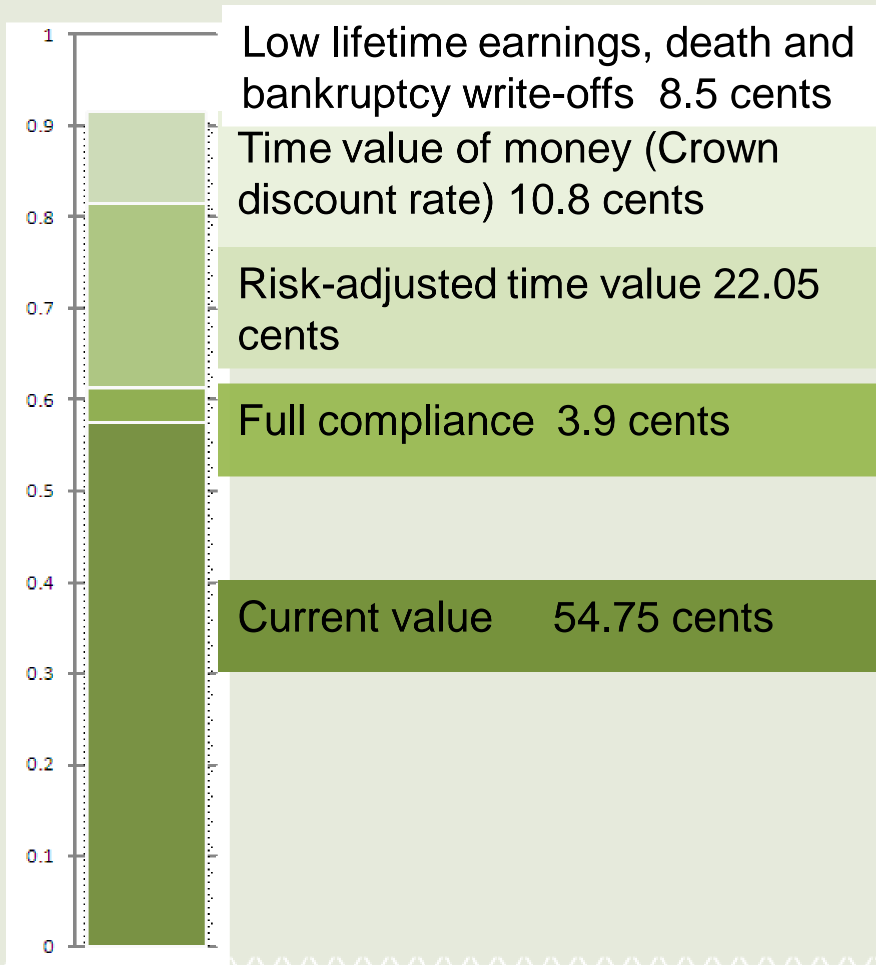
Where does the cost come from?



Current value of new lending is **54.8** cents.

If all borrowers were compliant the value of lending would be **58.7** cents. (**3.1** cent increase from OBB, **0.8** cents from NZB).

The Government does not recover the real cost of money lent, and does not get a risk margin. Charging interest at 6.7% to all borrowers would increase value to **80.8** cents.

Charging interest at the full Crown discount rate would increase value to approximately **91.5** cents.

The remaining write-down is due to earnings below the repayment threshold.

The next slides focus on the main sources of cost: slow or no repayments.

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Costs: Low incomes after leaving study (2006 leavers)

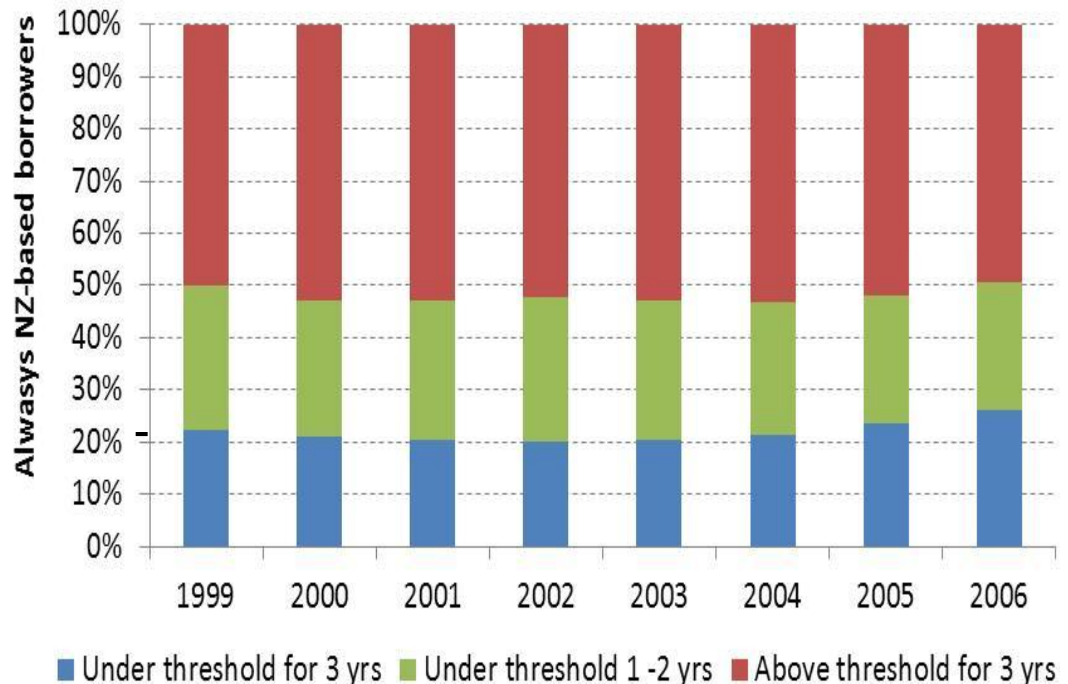
Around 50% of NZ resident borrowers had income below the repayment threshold for at least one year

For the 2006 cohort:

26% were under the repayment threshold for all three years.

80% of those consistently under the threshold received more than half their income from benefit 3 years after finishing study.

Similar characteristics to slow repayers.



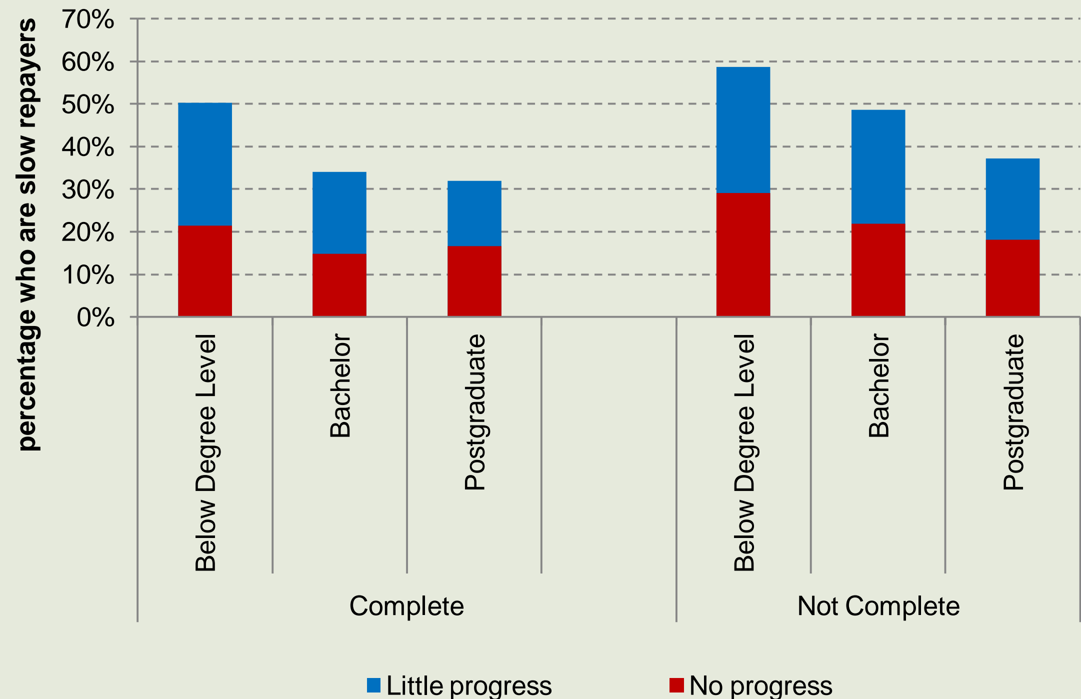
Costs: Slow repayers
(2006 leavers who stay in New Zealand)

41% are 'slow repayers' = 85%+ of loan balance remains after 3 years.

69% studied below degree level:

- food, hospitality
- creative arts
- society and culture

A high proportion of older borrowers and permanent residents, but low numbers.



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How do we compare? English loans

- England uses the same accounting treatment as NZ, unlike Australia
- The English scheme differs from ours in three key respects:
  - borrowers pay interest
  - loans are largely directed to higher education students (not further education students) who have better employment and income prospects
  - the repayment threshold is relatively high compared with NZ (£27,000 against less than $20,000)
- England has relatively less migration after study, and its migration is often to EU countries – so it focusses on EU solutions.

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NZ vs England

Key loan scheme valuation metrics – England and New Zealand

Metric	England 31 March 2011	NZ 30 June 2011
Ratio of carrying value to nominal	72%	62%
Initial fair value write-down	35%	46%
Shift in value 2010-2011 due to revaluation	-9%	+2%

What is the long-term forecast?

- In general, loan schemes become less valuable over time: high-value debt is paid off and low-value debt remains.

- A 2011 long-term forecast of the loan scheme found that by 2052 the loan scheme will have:
  - reached $34b carrying value and $61b nominal value

    now $7.8b and $12.9b
  - a carrying value 56% of the nominal value

    now 62%
  - new borrowing of $5b per annum

    now $1.6b
  - repayments over $3b per annum

    now $0.8b

What is being done in response?

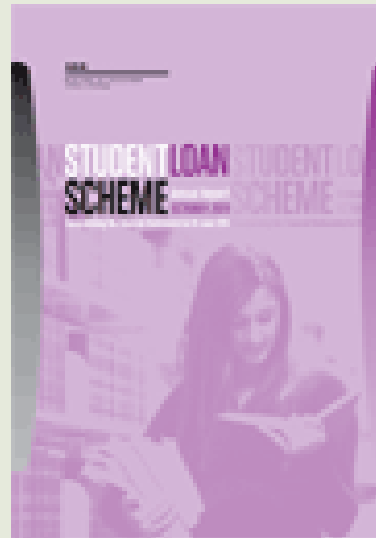
- Improving tertiary education system performance will improve the loan scheme's performance:
  - Performance-linked funding
  - Better information for students' decision-making
  - Reducing lower-value provision

- Setting limits on loan eligibility:
  - Budget 2010 changes: stand-down periods for new residents, performance requirements
  - Budget 2011 changes: limiting eligibility for older students, clarifying part-time eligibility

- Increasing repayment rates:
  - Broadening repayment obligations in Budget 2011
  - Improving overseas compliance

Questions?

www.educationcounts.govt.nz



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