

# THE IMPACT OF THE RECENT ECONOMIC CRISIS ON LAW SCHOOL BORROWERS

*by Christopher P. Chapman*

**I**t should come as no surprise that lawyers and the practice of law are not immune from the financial stress being experienced by virtually every sector of the economy. Negative repercussions from lingering macroeconomic challenges and a sluggish labor market continue to ripple from the largest big-city law firms to small-town sole practitioners.

Anecdotal and secondary evidence of these trends abounds. Many law firms have downsized considerably, and in some extreme cases, have actually ceased operating. Firms have reduced recruiting activities for new attorneys, deferred associate start dates, and reduced lawyer salaries.

As summarized in James Leipold's article elsewhere in this issue, the National Association for Law Placement (NALP) has reported that

[a]ll of the markers that measure the strength of the legal employment market for new lawyers, such as law firm recruiting levels for summer programs and summer program outcomes, fell in 2009, continuing and accelerating the general downward trend in recruiting volumes that was measured in 2008. The drop-off in the numbers in the second year of the recession was steeper than the decrease in volume seen during the first year of the recession. . . . From the employer perspective, over half of the summer 2008 associates (class of 2009 graduates) ac-

counted for in the survey were deferred beyond December 1, 2009.<sup>1</sup>

While the data for the class of 2010 are not yet available, the data are not expected to show any improvement.

## FINANCING LEGAL EDUCATION: AN INCREASE IN STUDENT LOANS

Direct evidence of the current economic climate's toll on lawyers is in limited supply. But for many years, a high proportion of law school students have relied on student loans to finance their law degrees. Comparing loan repayment performance of various graduating classes at similar stages of repayment opens a window into the impact of the current economic environment on lawyers. Before delving into this performance detail, a short review of the basics of law school borrowing will provide context for the discussion that follows.

Historically, law students have utilized a combination of grants, scholarships, savings, and student loans to finance their legal education. Consistent with the overall financing trends in postsecondary education during the past 30 years, the ratios of each broad financing category have shifted from a large percentage of the cost being covered by grants and scholarships to a large percentage being covered by student loans.

Broadly speaking, policy decisions at the state and federal level in favor of loan funding for higher

education (and particularly for graduate/professional education) and increased demand for a legal education have driven this shift. Dissecting the decisions and details surrounding this issue ultimately arrives at questions about the increasing cost of a legal education. Though interesting and subject to much current debate, these topics are outside the scope of this article.

## FEDERAL AND PRIVATE LOANS

Law students typically borrow from either or both of two loan programs—generically known as federal loans and private loans.

*Federal loans*, sometimes known as “guaranteed loans” if they are made by private lenders or “direct loans” if they are made by the U.S. Department of Education, form the base of the loan program at virtually every law school. The terms and conditions of federal loans are usually materially more favorable to the borrower than those of other consumer loan sources, and generally require only the most limited credit review. The largest federal loan program is known as the Stafford Loan and provides financing to all eligible students at eligible schools up to loan limits set by Congress.

Because federal loan limits have often failed to keep up with the rising cost of a legal education, *private loans*—education loans that are effectively non-collateralized specialty consumer loans—are offered by banks and other financial services providers to bridge this financing gap for students. Private loans

require credit underwriting and generally have more restrictive terms and conditions than federal loans, although much better terms than other financing alternatives such as credit cards, signature loans, and, in many cases, home equity lines of credit.

Prior to the 2006–2007 academic year, the ratio of federal to private loans for law students was approximately 60:40, with private loans growing each year.

However, effective July 1, 2006, an existing federal program of loans known as PLUS Loans became available to graduate and professional students (commonly known as Grad PLUS Loans), allowing them to borrow up to the entire cost of their legal education less any other financial aid. PLUS Loan availability largely eliminated the need for private education loans for law students. Following this development, virtually all lending to law students has migrated to federal loans.

## ACCESS GROUP AND STUDENT LOAN REPAYMENT AS A PROXY MEASURE

Access Group (originally known as Law Access) is a national nonprofit student lender and servicer that was formed in 1983 and remains governed by the 191 state and nonprofit law schools accredited by the American Bar Association. Its mission is focused on ensuring that the country’s law students have sufficient and affordable access to funds for their legal education. Access Group currently manages more than \$8.5 billion of aggregate federal and private student loans, 70+% of which are affiliated with law school graduates. That experience, coupled with the

multiple billions of dollars of loans that have been made and repaid since its founding, gives Access Group a legitimate claim to be the foremost expert in this niche of student lending.

As a large originator and servicer of loans to law students, Access Group witnesses the impact of the negative economy on lawyers through the lens of various loan performance metrics. The key measures discussed in this article are the *forbearance rate* and the *default rate*.

Access Group tracks these metrics in multiple ways, but for the purpose of this analysis, I will focus on the performance of private education loans by repayment cohort. Although focusing on private loans limits the analysis somewhat, it will provide the clearest view of the relative performance of annual spring graduating classes without being skewed by the increasingly generous and flexible repayment programs offered by the federal loan programs.

### Access Group Private Loans

Access Group private education loans are subject to credit underwriting and offer variable interest rates, full deferral of principal and interest payments during the in-school period, and a nine-month grace period following separation from school. For the period of 2000–2008, Access Group originated multiple billions of dollars of private education loans to law students possessing an average credit score of 720; only 15% of the borrowers required a cosigner. Moreover, to prevent over-borrowing, in each case the student's school was required to certify that the

amount borrowed did not exceed the cost of attendance less other financial aid and loans received by the student.

### Forbearance Rates for Private Loans

Loan repayment generally begins upon the expiration of the grace period. In cases of financial hardship—which is defined broadly—during their loan repayment period, Access Group borrowers are granted up to an aggregate 12 months of forbearance

upon request. During the forbearance period, no loan payments are due. However, interest accrues on the outstanding balance and is capitalized at the end of the forbearance period, increasing the amount that must ultimately be repaid. Any additional forbearance beyond the initial period is subject to a much more rigorous review, requiring a showing of clear evidence that the borrower will be

able to begin making payments at the conclusion of the extended forbearance period. In no case is more than six additional months granted.

The forbearance rate for any group of loans is a key indicator of future delinquency and defaults, and one that is watched closely by Access Group and its bankers, credit providers, rating agencies, and others. Given the nature of student lending and the very common cash-flow issues that graduating students face in all fields of study, it is expected that many ultimately successful and conscientious borrowers will use forbearance at some time, especially shortly after leaving school. Concern is raised, however, when forbearance rates rise substantially over historical norms.

### *A Recent Increase in Forbearance Rates*

Not surprisingly, given the challenges for new lawyers in the current environment, the percentage of Access Group borrowers in forbearance on one or more private loans has increased significantly for recent graduating classes. Thirty-three percent of all borrowers for the class of 2008 in repayment only 6 months (or 15 months following graduation, including the 9-month grace period) were in forbearance versus 13% for the class of 2000 at the same point in their repayment (see Table 1). A slight drop to 29% was observed for the class of 2009, but it is not a significant improvement. The story is not much better for those borrowers who have been in repayment for 12 months (21 months following graduation). Only 12% of the class of 2000 were in forbearance in the twelfth month, but the percentage was more than double (25%) for the class of 2008.

Recent law school graduates are not the only borrowers who appear to be experiencing increased financial stress. Although the forbearance rates at later stages in repayment drop off considerably, we have observed a spike (nominally less severe than that at the beginning of repayment) in the percentage of borrowers requesting forbearance five to six years into repayment. In many cases, these borrowers did

not request forbearance when they initially entered repayment because they were employed and had the means to repay their loans. But due to recent job loss or other financial stress, borrowers who had been repaying their loans regularly since the repayment period began now need to temporarily postpone repayment. Moreover, an increase has also been observed in the number of borrowers appealing for additional time after exhausting the standard 12-month forbearance period.

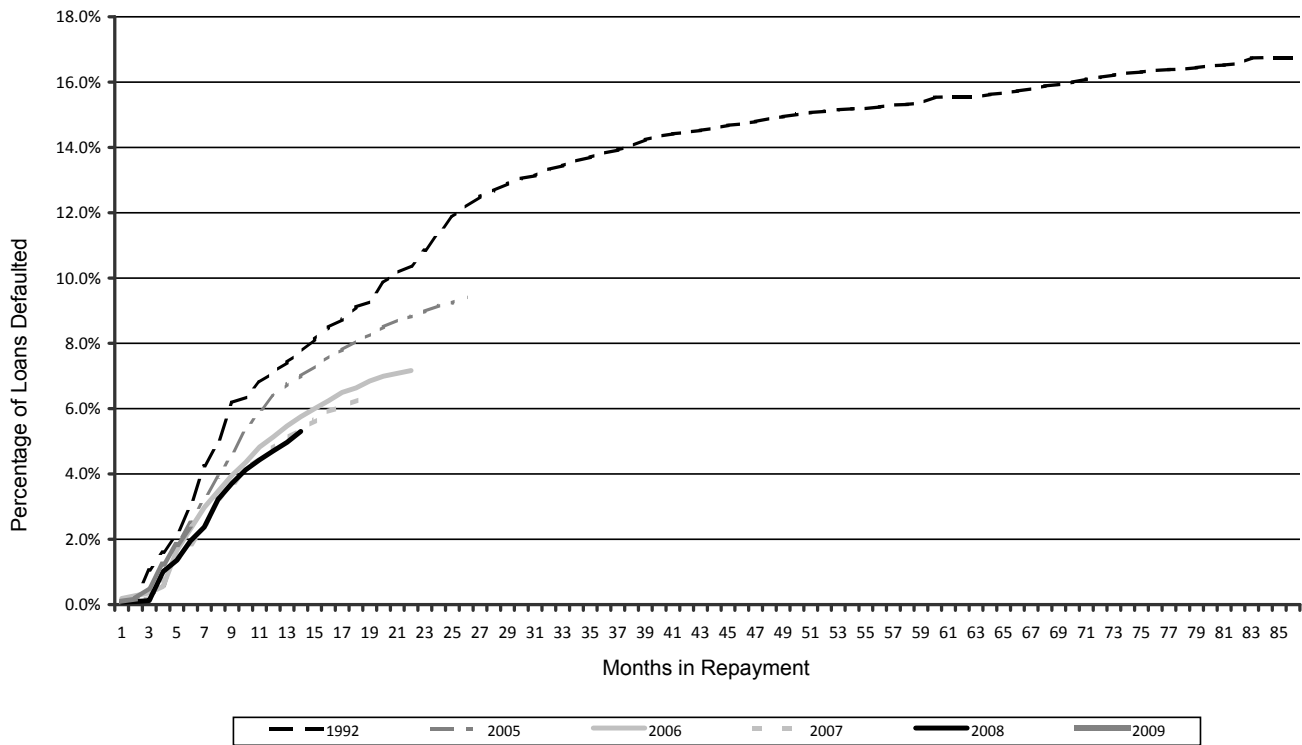
### **Default Rates for Private Loans**

Access Group's private loans are considered to be in default after 180 days of delinquency. In other words, a borrower can be five months behind on monthly payments without going into default, which begins with the sixth month. Access Group expends substantial resources to keep borrowers from defaulting on their loans, but the willingness and ability to repay sometimes elude borrowers despite everyone's best efforts.

While the legal economy's challenges today are substantial, they are not wholly unprecedented. Access Group first witnessed a significant increase in private loan defaults for the class of 1992, who entered the legal profession during a recessionary

**Table 1:** Percentage of Access Group Private Loan Borrowers in Forbearance, Select Classes from 2000 to 2009

Months in Repayment	Class of 2000	Class of 2002	Class of 2003	Class of 2006	Class of 2007	Class of 2008	Class of 2009
6	13%	18%	21%	23%	28%	33%	29%
12	12%	13%	11%	16%	23%	25%	?
30	3.5%	2.5%	2.3%	6.7%	6.5%	?	?
72	1.5%	2.5%	4.2%	?	?	?	?



**Figure 1:** Private loan repayment cohorts: cumulative default rates for the classes of 1992 and 2005–2009

period and experienced problems securing full-time legal employment and repaying their debt. Defaults for the class of 1992 have been higher than anticipated, reaching 17% to date, nearly double the expected rate (see Figure 1). At this point, many borrowers from this class have actually fully repaid their private loans, so few additional defaults are expected.

#### *Defaults Predicted for Recent Graduating Classes*

The four most recent graduating classes (2005–2008) with sufficient repayment data to comparatively measure defaults have performed generally as expected; however, an uptick in the trend lines for these more recent classes is anticipated. As discussed above, recent increases in the number of borrowers requesting forbearance suggest that defaults will

increase in the coming months and years as borrowers exhaust their forbearance eligibility. Even with Access Group’s efforts to keep borrowers in good standing, default may become the only option for some if the labor market for newer lawyers does not improve in the near future.

For the classes of 2008, 2009, and 2010, each graduating into a worse job market than the last, the prospects for loan repayment might appear to be grim. But, at least with respect to law school debt, a growing percentage of loans were made under the federal loan programs, which provide substantial opportunities to manage student loan obligations effectively (see more about these opportunities below) and thereby offer relief for lawyers affected by the economy.

### Federal Loan Forbearance and Default: Federal Regulations Provide Assistance

Stress is evident in Access Group's federal loan portfolio as well. Forbearance requests have increased, and delinquencies are up over prior years. With forbearance periods that can run into multiple years and default not occurring until a borrower is 270 days delinquent, it is too soon to determine whether these trends will translate into significant increases in federal loan defaults.

Mitigating the default risk of federal loans is the fact that federal regulations provide considerably more options and flexibility for borrowers, such as

- increased forbearance periods to postpone repayment when experiencing financial hardship;
- loan consolidation programs that can extend payments to 30 years, reducing monthly payments by as much as 50%;
- flexible repayment plans, including two (the Income-Based Repayment plan and the Income-Sensitive Repayment plan) that base the monthly payment on the borrower's income<sup>2</sup>; and
- loan forgiveness for those employed in public service, which can be particularly helpful to law students planning to pursue careers in public interest law or in the public sector.

### INCREASING LAW STUDENT INDEBTEDNESS

It is also worth noting that the increased level of indebtedness of recent law school graduates is compounding the external financial challenges they face. Law student borrowing is growing faster than recent increases in median starting salaries, suggesting that

recent graduates, as a whole, may be worse off financially than graduates five years ago.

The reality is that many law students who graduated in 2009 owed more on their student loans than they were earning initially in their first jobs as attorneys. Based on eligibility criteria for the IBR plan, these graduates are now experiencing partial financial hardship as they begin repaying their federal student loans. In the best of times this would have both short- and long-term financial consequences for these graduates as they begin their legal careers. For example, many borrowers may find it difficult, if not impossible, to afford home ownership, save for their children's education, or begin investing for retirement. Current economic conditions have the potential to make things even more difficult.

All law schools accredited by the American Bar Association report annually to the ABA on law student borrowing. Table 2 shows the average amount borrowed by students of public and private law schools for the graduating classes of 2002–2009. It is important to note that these data exclude student

**Table 2:** Average Amount Borrowed While in Law School, Classes of 2002–2009

Graduating Class	Public Law Schools	Private Law Schools
2002	\$43,175	\$69,098
2003	\$45,763	\$72,893
2004	\$48,910	\$76,563
2005	\$51,056	\$78,763
2006	\$54,509	\$83,181
2007	\$57,170	\$87,906
2008	\$71,436	\$91,506
2009	\$66,045	\$100,003

*Source:* ABA Section of Legal Education and Admissions to the Bar Annual Questionnaire, 2002–2009.

loans taken out prior to law school, the interest that accrued during law school and that will be capitalized on unsubsidized loans (i.e., unsubsidized Stafford Loans, PLUS Loans, and private student loans), or any loan funding for postgraduate activities such as preparing for the bar (e.g., bar exam loans).

To understand the impact of interest accrual on the average total debt in law school, Table 3 demonstrates the interest that could have accrued for the class of 2009 during the three years of law school and the six months immediately following graduation (the grace period for federal loans and for the majority of private loan programs). It also includes estimates of the monthly payment assuming fixed monthly payments over a 10-year repayment period (Standard Repayment Plan) and a 25-year repayment period (Extended Repayment Plan). (Calculations assume a typical mix of federal loans—including subsidized and unsubsidized Stafford Loans and Grad PLUS Loans—at current statutory rates.)

The median starting salary for the class of 2009 was \$72,000.<sup>3</sup> This median was unchanged from that reported for the class of 2008. Individuals who

graduate with educational debt exceeding their starting salaries could very well experience financial stress in repaying their education loans (at least in the early years of loan repayment). Therefore, graduates of private law schools in 2009 with average or higher amounts of student loan debt likely will experience financial stress. In fact, even graduates of public law schools could very well have challenges initially in repaying their loans without extending repayment to 25 years or using the IBR plan.

### ACCESS GROUP EFFORTS TO REMEDIATE BORROWER STRESS

Access Group continues to support a strong borrower education program. Educating borrowers on their repayment options has become increasingly important as the loan programs have become more complex in structure. This complexity stems from the vast array of options that are available to borrowers, particularly with federal loans. Helping borrowers understand their options so that they can make the choices that best meet their needs continues to be an important activity if borrowers are to be successful in repaying their loans.

Considerable attention is paid to educating Access Group borrowers about loan repayment options and strategies for managing their debt. These efforts include

- school seminars presented by Access Group staff to students in their final term of enrollment;
- training for financial aid administrators at conferences and through one-on-one consultations;
- online calculators and detailed educational information on the Access Group website

**Table 3:** Estimated Total Debt and Monthly Payments for the Class of 2009

	Public Law Schools	Private Law Schools
Average amount borrowed	\$66,045	\$100,003
Estimated accrued interest (during law school and post-graduation grace period)	\$6,000	\$11,600
<b>Average debt at repayment</b>	<b>\$72,045</b>	<b>\$111,603</b>
Monthly payment: Standard Repayment Plan (10-year term)	\$832	\$1,310
Monthly payment: Extended Repayment Plan (25-year term)	\$504	\$807

to help borrowers estimate monthly loan payments and research options for lowering monthly payments;

- a comprehensive repayment booklet sent to each borrower prior to the start of repayment as part of Access Group servicing operations;
- live webinars presented for borrowers who are entering repayment, with recordings posted to the Access Group website for later review by any interested borrowers; and
- extensive training for internal customer service staff on an ongoing basis to maintain accurate and high-quality counseling for borrowers.


## FUTURE PROSPECTS

The magnitude and speed of the economic recovery in the United States will likely parallel the financial fortunes of lawyers. Access Group expects to see any positive change reflected in student loan repayment performance rates.

There is a question, however, as to whether the breadth and depth of the “Great Recession” and its longer-term impacts—such as the drag on future growth from increased national debt, tighter consumer and commercial credit, and depressed consumer spending—will limit the recovery. Given the relatively higher debt load that newer law school graduates are carrying, these factors could sub-

stantially affect earning potential for an extended period.

The ever-increasing cost of higher education, including legal education, must be addressed in a meaningful manner in the near future. While expanded access to the federal loan programs for law school mostly ensure that no law student will be turned away from school for lack of funds, such access also causes prospective students to become even less sensitive to the cost of education and frees institutions from the market pressure that might result from greater sensitivity. We recognize the complexity of this issue, but it is central to the long-term financial outcomes for law school graduates.

Whatever direction the economy moves in, law school graduates are generally well positioned to survive and thrive. The rigor of a legal education combined with the self-selection process among those who attend law school provides law school graduates with the flexibility to be highly competitive in any labor market. With this flexibility and the increased federal loan program options, lawyers should be able to weather this storm. 

## NOTES

1. NALP, *Entry-Level Recruiting Volumes Plunge, Some Start Dates Deferred* (Mar. 2, 2010). The survey results referred to consist of information provided by NALP members about fall 2009 recruiting.
2. The new Income-Based Repayment (IBR) plan bases the monthly payment for a borrower who is experiencing partial financial hardship on the borrower’s household adjusted gross income, household size, and the federal poverty guideline. Although “partial financial hardship” has a precise and somewhat complex definition, generally



borrowers with federal loan debt in excess of their household's adjusted gross income will qualify. And unlike the Standard, Graduated, and Extended federal loan repayment plans, the IBR plan permits negative amortization, thereby allowing for monthly payments as low as \$0 if the circumstances warrant.

The Income-Sensitive Repayment plan is available for federal loans only. Monthly payments are equal to the greater of four percent of a borrower's total monthly gross income or the monthly interest accrual. The repayment period can be up to 15 years. Payments are adjusted annually, with no single required payment permitted to be three times greater than any other required payment.

3. NALP, *Jobs & JD's: Employment and Salaries of New Law Graduates, Class of 2009* (2010).



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