FRANKLIN TEMPLETON INVESTMENTS

Topic Paper
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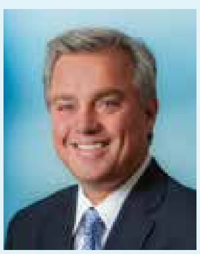
BORROW WISELY: THE ROLE OF STUDENT DEBT

Remember back in the good ol' days, when college-bound high school seniors occupied themselves with pondering their preferences: East or West Coast? Large or small campus? Thousands of miles from home or close enough to return for Sunday night dinners? Paying for education was a serious consideration, too, but tuition and fees were substantially cheaper.



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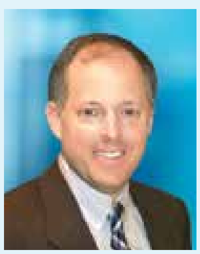

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Today things have changed. After adjusting for inflation, average tuition and fees for in-state residents at a four-year public college or university is 213% higher than 30 years ago.[1] These rising college tuition prices can feel intimidating and trigger worries about how to cover these rising costs.

Many parents and students look toward loans to cover this climbing cost, which leads to graduates emerging from college with tens of thousands in debt. The skyrocketing student loan balances leave many students wondering whether or not college is the worthwhile investment it used to be.

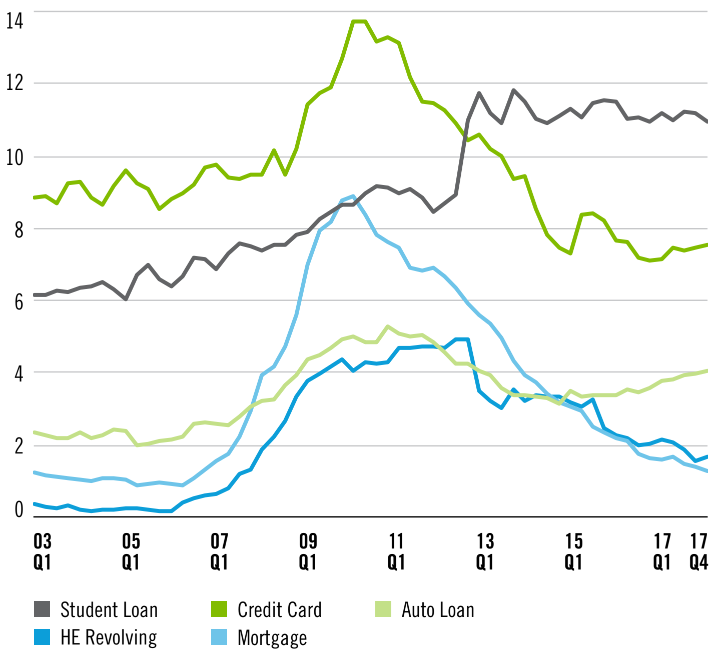
Student Loan Debt Is Growing

The student loan crisis is real. Americans have amassed a record-high $1.4 trillion in student loan debt,[2] with the average college graduate emerging with approximately $39,400 in student debt. Student loan debt exceeds all other forms of consumer debt except mortgages.

The repercussions can be severe. Student loan debt is a burden that many people cannot afford, and a higher percentage of people are delinquent on their loan payments than on their credit cards, according to the FRBNY Consumer Credit Panel/Equifax.

STUDENT LOAN DELINQUENCIES RISE AS OTHERS FALL

Percent of balance 90+ days delinquent by loan type



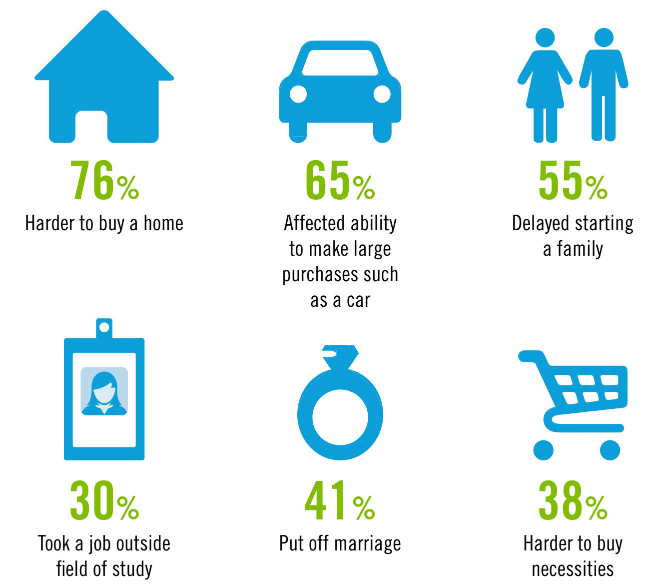
Source: FRBNY Consumer Credit Panel/Equifax, 02/2018.

The consequences of this debt can be felt both broadly throughout the economy as well as on a personal basis. High loan balances, especially for people in default, can negatively impact financial decisions many years after college. Buying a home, purchasing an automobile, getting married and starting a family are major life experiences that come with a price tag, and these big events can be delayed—if not denied—for people who carry too much student loan debt. One staggering statistic: half of borrowers said their loans caused them to delay starting a family.

Source: American Student Assistance® and Realtors®, Student Loan Debt and Housing Report, 2017.

THE DEBT IMPACT

Percent of student borrowers who said loans had this effect



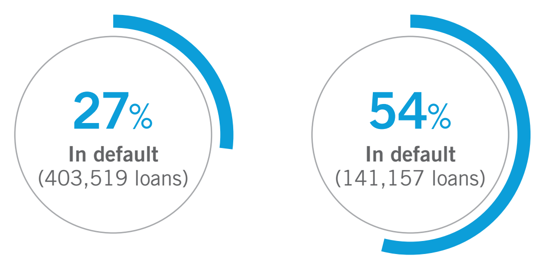
Source: American Student Assistance® and Realtors®, Student Loan Debt and Housing Report, 2017.

Student loan debt is not only for the young. Although older borrowers have fewer federal student loans, their default rate is much higher than that of younger borrowers.

For individuals aged 25–49 that held federal student loans, only 12 percent were in default, while 27 percent of loans held by individuals 65 to 74 were in default, and more than half of loans held by individuals 75 or older were in default.

RETIREMENT DERAILED

Student loan defaults rise as people age



Age 65–74
1.5 mil. loans

75 and older
259,992 loans

This is having an impact on their retirement income. The number of people whose Social Security checks are garnished due to student loan defaults has skyrocketed in recent years, increasing fivefold since 2001.

Source: United States Government Accountability Office, Testimony Before the Special Committee on Aging, U.S. Senate, Wednesday, September 10, 2014. http://www.gao.gov/assets/670/665709.pdf.

Is College Still Worth It… Even with Student Loans?

Given these statistics, it's natural that many students wonder if a college degree is still worth as much as it used to be. A strong case can be made for "yes."

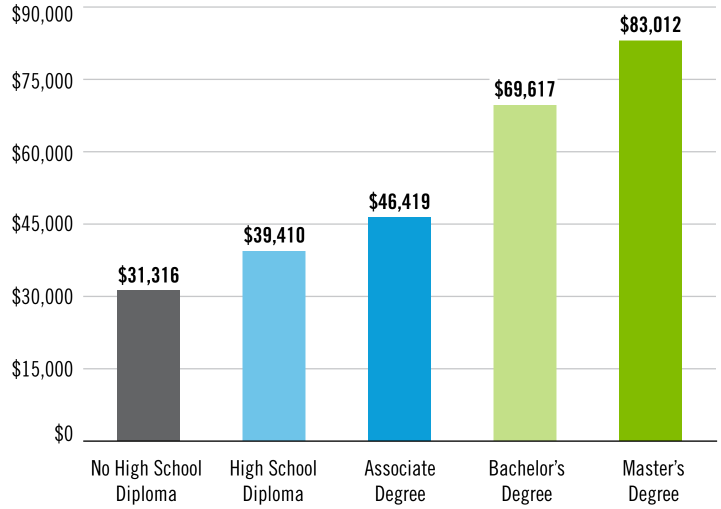
1. College Graduates Earn More

A college degree can still make the difference between a low-paying and high-paying job. In fact, it makes a bigger difference now than ever before.

The U.S. Census Bureau reports the income difference between young adults with a high school degree, two-year degree and four-year degree has widened steadily since the 1960s. Among full-time workers ages 25 to 34, median income with only a high school degree stands at $39,410, while median income for those with a college degree jumps to $83,012.

EDUCATION IMPACTS EARNINGS

Average earnings in 2016 by education level



Source: U.S. Census Bureau, *Current Population Survey*, 2017 Annual Social and Economic Supplement.

Real Life Stories: Bryan and Julie

My twin brother Bryan and I graduated from high school in Indiana. We had B+ averages, played soccer, and held big dreams.

After graduation, Bryan started working, bringing home $27,040 annually after taxes. He rented his own apartment and saved 10 percent of his paychecks. After four years, he amassed $10,800 in savings and made a 10-percent down payment on a modest house. Other than his mortgage, he's always been debt-free.

Compared to him, I felt like a chump. I enrolled in college, which meant I was perpetually broke. I lived with mom and graduated with $32,000 in debt.

The tables turned after graduation.

I took a job in advertising, earning $40,000 after taxes. I matched Bryan's lifestyle, living on a budget of $25,000 annually, and wiped out my debt in two years. Now I'm debt-free and make more than my brother… though he can still beat me at soccer.

2. College Graduates Have Lower Levels of Unemployment

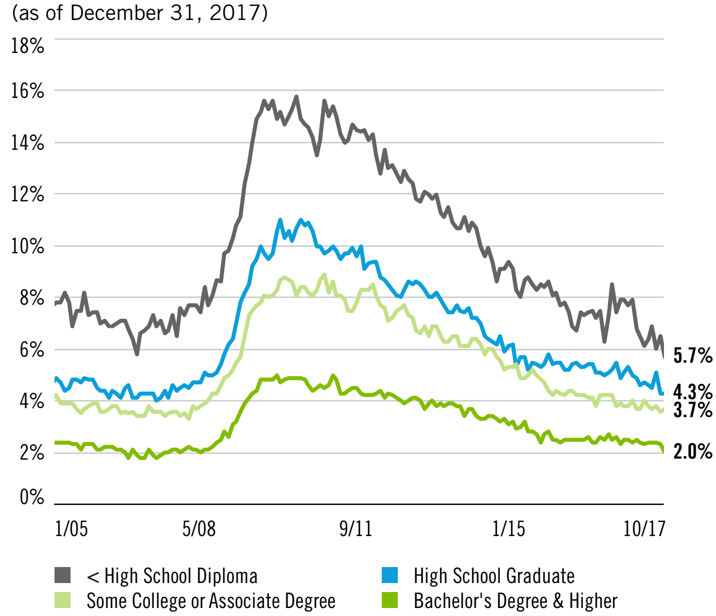
At a time when unemployment is still a concern, those with college degrees can find themselves better prepared to weather the unemployment storm. People whose highest level of education is a high school diploma are twice as likely to be unemployed.

As the chart below demonstrates, 2.0 percent of people with a college degree or higher faced unemployment in December 2017, compared to 4.3 percent (more than double that amount) of those with only a high school education.

LOOKING FOR WORK? A DEGREE HELPS

Unemployment rates by education level

(as of December 31, 2017)



Source: U.S. Department of Labor, Bureau of Labor Statistics, Current Population Survey. National Bureau of Economic Research, Table A-4. Employment status of the civilian population 25 years and over by educational attainment.

3. A College Degree Can Pay for Itself[3]

A college degree is still an investment that will usually provide positive return. The degree generally pays for itself many times over.

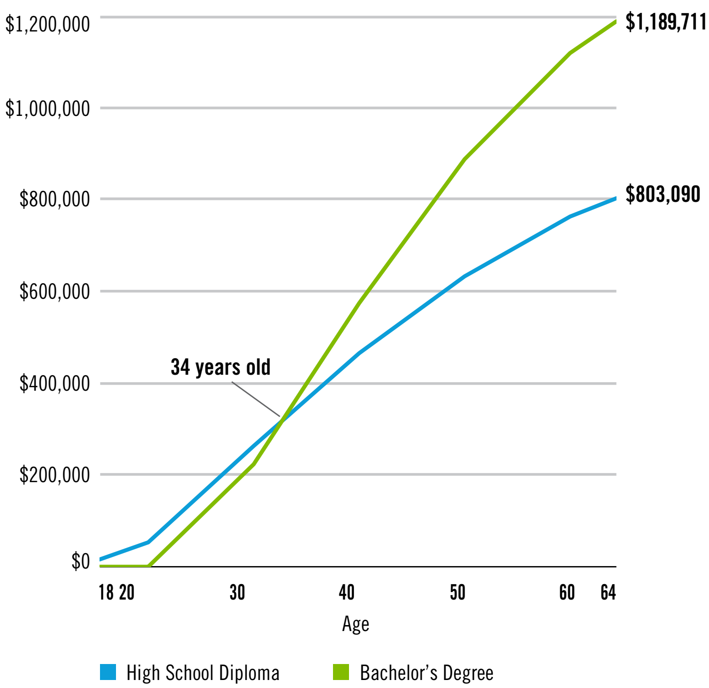
College graduates earn nearly 48 percent more over the course of their lifetime than high school graduates, even after factoring in tuition and loan repayment costs, according to research by the College Board of Education. In fact, assuming that the student borrowed the entire cost of tuition and fees—$17,190 the first year and 4.29 additional percent every year thereafter—their diploma would still pay for itself by the time they turn 34.

The next three decades of their working career (age 35 to 65) widen the income gap between people with high school diplomas vs. bachelor degrees; the college graduates ultimately earn over $385,000 more than their high school diploma counterparts over the course of their lifetime.

In other words, investing $60,000 into a degree can yield returns of more than $385,000 over the span of a person's career. Student loans fund the upfront investment but the payoff over the long term can be worth it.

RETURN ON INVESTMENT

Estimated cumulative earnings net of loan repayment for tuition and fees



Sources: U.S. Census Bureau, American Community Survey, 2010–2014 Five-Year Public Use Microdata Sample; College Board, Trends in College Pricing 2016; calculations by the authors. Excludes bachelor's degree recipients who earn advanced degrees. Assume students borrow the cost of tuition and fees and books and supplies and pay it off over 10 years after graduation with a 4.29% annual interest rate during and after college. Tuition/loan payments and earnings are discounted at 3%, compounded every year beyond age 18.

4. College Is More than Just a Degree

Is college expensive? Yes. There's no denying that. The College Board estimates that the average annual tuition for an in-state public school student during the 2017–2018 school year was $20,770, while the average cost for out-of-state residents at public universities was $36,420. But there's more to the financial equation than numbers alone.

College does more than simply prepare students for a career. It's also a highly formative period of life when students develop their self-identity, form lifelong friendships and business contacts, discover new fields and launch their careers.

Rachel's Story: From $11 an Hour to Biomedical Engineer

I grew up on a small farm about 30 minutes outside of Youngstown, Ohio, a town of about 67,000 people. I'm the first person in my family to attend college.

My parents didn't set aside any college savings for me, so when I graduated from high school, I thought about staying in Youngstown and working. My uncle and aunt own a small shop and offered me a full-time position, paying $11 per hour. I almost accepted their offer, especially since the alternative was taking out big loans to go to college. Besides, lots of my friends are staying in town.

But instead, I took out loans and moved to Columbus to attend Ohio State University where the student population is about the size of my entire hometown. As soon as I arrived, I faced a whole new world of ideas and experiences that I had never encountered. Everything seems strange and foreign. I enrolled in several clubs and organizations to meet people and try new things. I volunteer once a week at an animal shelter, practice a Brazilian martial art called capoeira, and joined a bocce ball league.

By the spring semester of my freshman year, I discovered that I have a strong interest in biomedical research. I was recently accepted into the biomedical engineering major.

I feel grateful that I've been able to experience two different worlds: my small-town roots and the wide world of opportunities that college presented. My life is more well-rounded and I'm now entering a promising field that I never previously had considered.

Paying for education without Student Loans

How can you enjoy all that value without going into mountains of debt?

It all comes down to rethinking how you approach paying for education. Don't assume you can (or should) rely solely on loans. Consider finding other ways of financing your education first, and using student loans only as a last resort.

1. Save First

No matter how old your child is, it's important to start saving right away. (If you're a student putting yourself through school, start saving as early as possible.)

The earlier you begin saving, the more time your money has to grow, which is why it can be beneficial to start saving at an early age. Consider the following graph, which shows a hypothetical example of the difference between saving regularly over the course of 18 years versus paying for a full college loan out of pocket.

Real Life Stories: I Helped Send My Grandson to College

My name is Gary. I retired in 2010 and my wife Linda retired in 2012 from her position as an in-house counsel for a consulting group.

We have three children, all of whom are married. Liam, our eldest, has a 16-year-old son who will be starting college in less than two years.

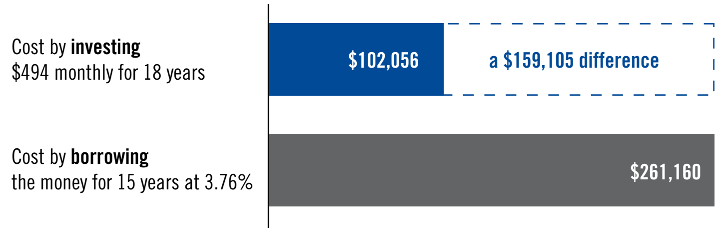
Our grandson Dennis is bright and hardworking, and we had assumed that Liam and his wife were preparing to send him to college. We don't openly talk about money in our family, assuming that no news is good news. So we were caught off-guard when Liam told us that he had very little set aside for Dennis' education.

Linda and I are fortunately in a good position. We met with a financial planner and worked out how we could open a 529 plan, with Dennis as the beneficiary, and maximize our contributions. Although we started late and our contributions only have a few years to grow, they did make a difference. Dennis can now go to a school with a very good architecture program.

We regret that we didn't start saving for Dennis' education earlier. We learned our lesson, though. Now we have 529 accounts set up for our other three grandchildren. All of them are still under age 10 and we're glad we have time for their college funds to grow.

COLLEGE SAVINGS VERSUS BORROWING

Over a $155,000 difference in the total "out-of-pocket" amount



Source: The College Board, Trends in College Pricing, 2017. Projected cost based upon child's entrance to college for four years at a public college. Figure is based upon the 4.36% 10-year average annual increase in public college costs, as reported by The College Board for the 2017–2018 school year. Cost includes tuition, fees and room and board. The borrowing example assumes a fixed interest rate of 3.76% based on a subsidized Stafford loan issued between 7/1/2017–7/1/2018. Examples are for illustrative purposes only, are not representative of any particular investment, and do not take taxes into account. Investments do not guarantee any specific rate of return, and you may have a gain or a loss on the amounts invested. Periodic investing plans do not assure a profit and do not protect against loss in a declining market.

Small investments make a big difference. Paying $1 per day into a savings plan for 18 years (total contribution: $6,570) can reduce a student loan payment by $150 per month over the span of a 10-year repayment schedule (total savings: $18,000).[4] Periodic investing plans do not assure a profit and do not protect against loss in a declining market.

Worried about the impact of savings on your financial aid eligibility? As a general rule, the benefit of saving outweighs the potential financial aid impact if you keep the savings in the parents' name. If the savings are in the child's name, there is a much greater impact on financial aid.

Ask Family and Friends for Support

Don't forget that grandparents, uncles, aunts, godparents, other family members and even close friends may be willing to contribute to a student's savings goals. Anyone can open a 529 savings account in a beneficiary's name, regardless of whether or not they're related to that person.

Note that your family and friends are unlikely to contribute towards your mortgage or retirement funds, but they may contribute to a 529 savings plan, so it may make sense to divert your money towards your own retirement funds if you think you can gather support for your child's education from extended family.

2. Look for Grants and Scholarships

In 2016–17 alone, $239.1 billion in grants and scholarships were available for undergraduate and graduate students.[5]

Websites such as **FastWeb.com** and **FinAid.org** can help people discover which grants and scholarships they can apply for. Local community organizations, religious organizations and alumni organizations also provide strong resources. Small amounts add up, so apply for everything you may qualify for. Don't imagine that you'll get "a scholarship"—be prepared to receive several scholarships, each comprising of $500 or $1,000, until they collectively add to a five-figure discount.

3. Use Debt to Fill In the Gaps

Consider not using debt to attend a more expensive college than necessary, and don't slack off when it comes to building savings and applying for scholarships and grants. Loans can be a useful stopgap to supplement your tuition costs but relying on debt alone has drawbacks.

4. Make Smart Decisions

Get the best bang for your buck by remembering a few key facts: the advertised sticker price isn't the final price; a more expensive school doesn't necessarily produce graduates with higher starting salaries or lower unemployment rates; your post-collegiate success will depend on a number of factors including your choice of major and the number of years it takes you to graduate.

Let's elaborate:

Before You Go to College

Know the numbers—Know what your prospective college(s) will really cost after financial aid; higher tuition may not necessarily mean higher out-of-pocket expenses. Many colleges discount their advertised prices through funds from their endowment.

Shop around—Price shop for your respective major; there may be many state schools that are highly ranked for your degree and cost a fraction of what you'd pay for a private school education.

Be passionate—Make sure you've entered a major you're truly passionate about, as changing majors mid-college can be costly. Borrow only to cover a portion of the tuition and fees; work part-time to earn money for living costs such as food and textbooks. Look into work-study opportunities that can help you cover some educational expenses.

Understand the return on investment—Get clear on what your income potential will be from your college and major. Nursing, architecture, accounting and engineering are some examples of well-paid fields that require an undergraduate degree, while other fields and majors may not translate to as much monetary success. Visit **http://collegecost.ed.gov/** for information that can help to find the best value for your college requirements (major, location, size, etc.).

Plan your finish—Commit to finishing your diploma in four years or less. The cost of attending college for a fifth year will harm you in two ways: you'll not only need to pay for an extra semester or year of education, you'll also miss the potential opportunity to earn a full-time income during that year. Planning a four-year graduation may require that you strategize your course selection upfront, so that a missed prerequisite doesn't hold you back.

While You're in College

Stay in school—If you've already invested 3–4 years and have taken on debt, consider carefully before dropping out. It may be worthwhile to take on additional debt if need be so that you can graduate. Your post-college earnings on a finished degree can be significantly higher than your earnings after completing "some college" but walking away without a diploma.

Don't change majors—If possible, avoid changing majors if doing so results in needing longer than four years to finish the degree. Consult an academic advisor or major advisor if you have questions about the impact of a changing your major on your graduation date. If you're interested in another field, see if you can minor in that field or perform related internships.

Take summer classes—Look into the cost of attending summer school to get the credit you need at a lower cost; many schools offer discounts for their summer classes.

Live at home—If your school is close to home, consider living at home and commuting to save money on room and board. (You may be so busy that you won't be at home much, anyway.)

Prepare for graduation—Attend to financial planning while you're still in college to be prepared for your first day as a graduate. Creating a budget and lining up a secure job will make it easier to start paying down any student loans you've accrued.

Final Thoughts

The simple truth is that student loans are neither “good” nor “bad.” They’re simply a tool.

Used correctly, student loans can help you afford college and gain access to a better life. Used injudiciously, however, they can saddle you with hefty payments at the beginning of your career, which may impact your job mobility or cause you to delay other milestones like buying a home or starting a family.

Ultimately, college affordability is the culmination of many little steps, ranging from finishing a degree on time (or early) to taking summer courses; from living at home to selecting an affordable institution; from carefully selecting a major to carefully charting out a courseload.

While you may want to consider taking other steps, such as saving money, utilizing tax-advantaged savings plans like the 529 and Coverdell plans, and looking for grants and scholarships, loans can be useful in bridging the final gap between savings and final costs.

In spite of the negative press, student loan debt can be a helpful tool that prepares you to enjoy a successful career. Borrow wisely and enjoy the fruits for decades to come.

1. Source: College Board, Trends in College Pricing 2017.
2. Source: BOARD OF GOVERNORS of the FEDERAL RESERVE SYSTEM, https://www.federalreserve.gov/releases/g19/current/default.htm, June 2018.
3. Source: College Board, Education Pays 2016, as of December 2016.
4. The saving example assumed an annual rate of return of 7.50% during a period of 18 years (or 216 months) at $30/month. The borrowing example assumes a fixed interest loan rate of 5.50%.
5. The College Board, Trends in Student Aid 2017, Table 1.

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