Has Education Failed You?

Antony Davies

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www.antonydavies.org

How the Mortgage Market Works

Safe Borrowers

Safe Mortgage

Commercial Banks

Risky Mortgage

Risky Borrowers

Investment Banks (Lehmann Brothers)

Hedge Funds

Mortgage Backed Security

Commercial Banks

Reinsurance Companies (AIG)

Pension Funds

Other Large Savers

End result: How it's supposed to work

1. People with savings loan to people who buy houses.

2. People who borrowed make payments.

3. Free market interest rate regulates risk.

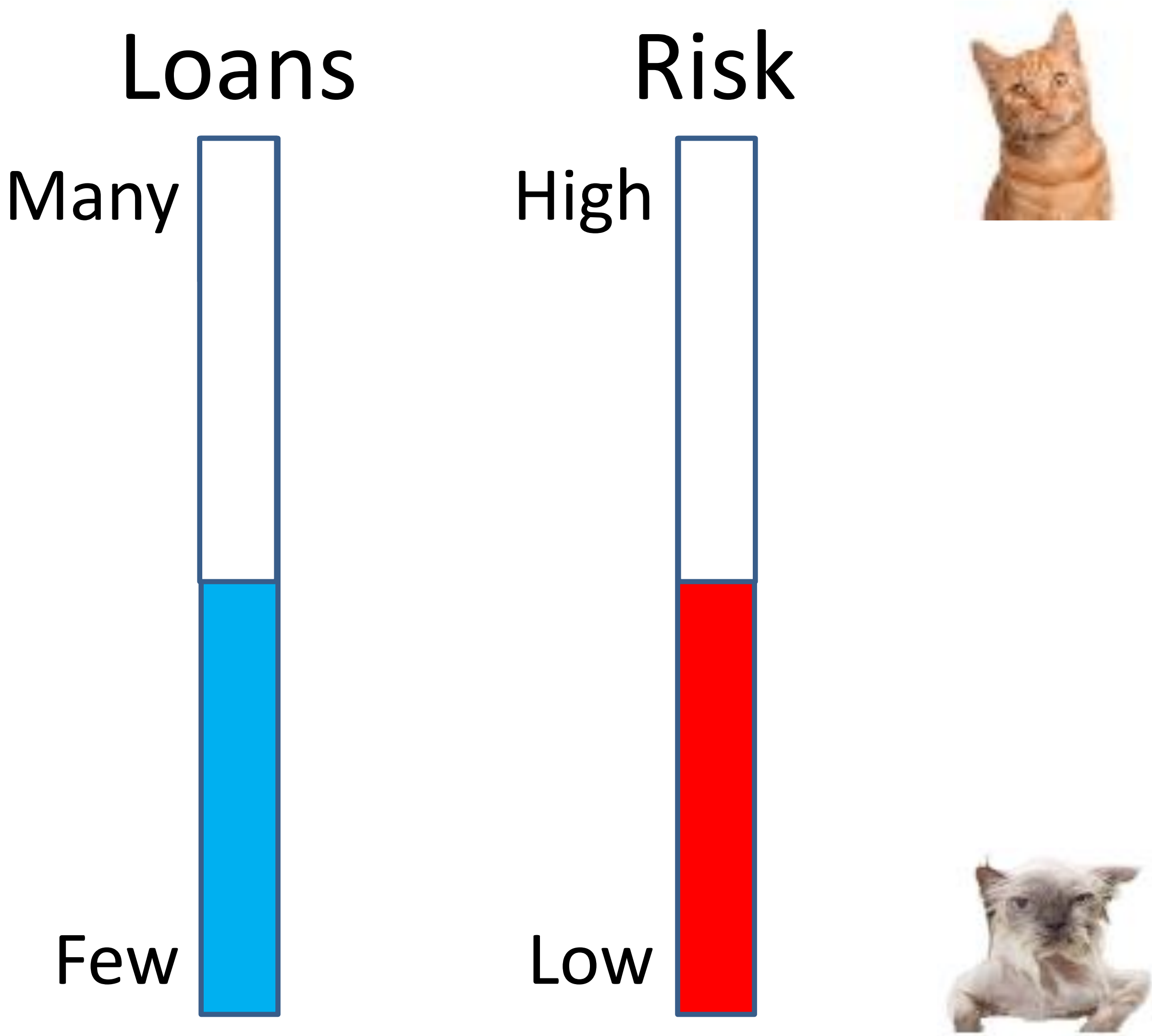
How did government short-circuit the process?

Two government players enter the game.

Low interest rates make borrowing artificially less expensive.

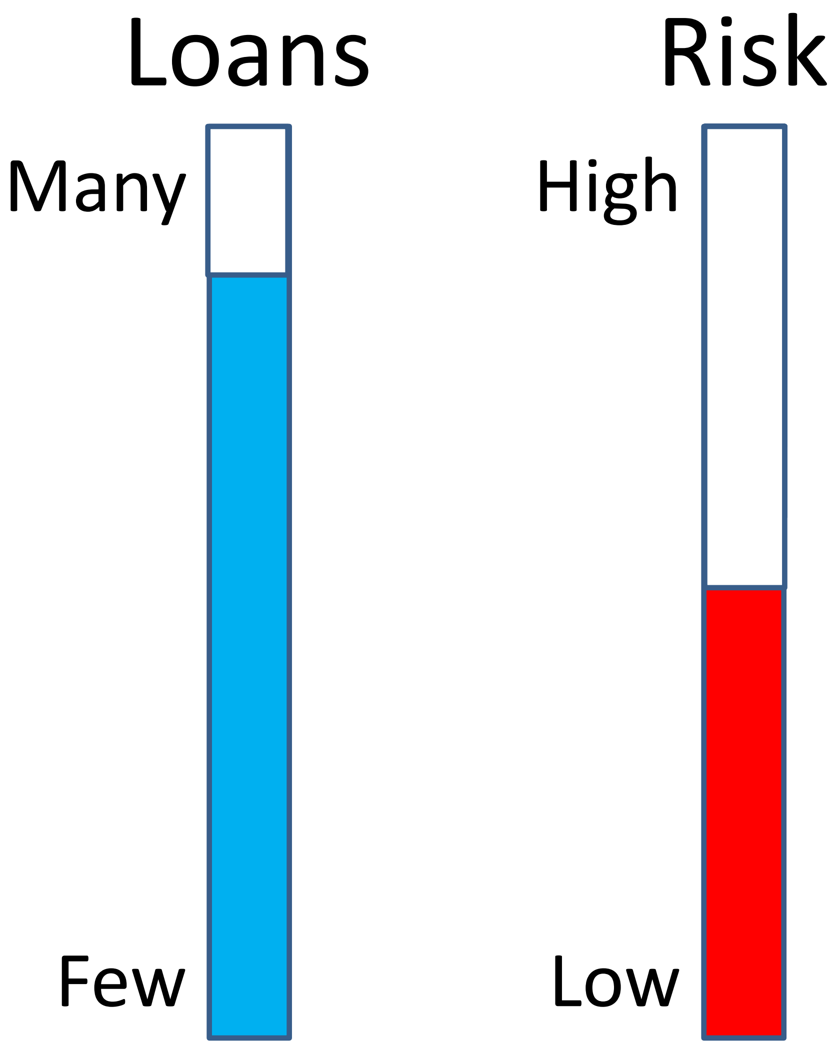
Buy mortgages with little regard for risk.

Federal Reserve: Low Interest Rates



FannieMae
Freddie Mac
We make home possible℠

F&F: Remove Lending Risk



What does this do to housing prices?

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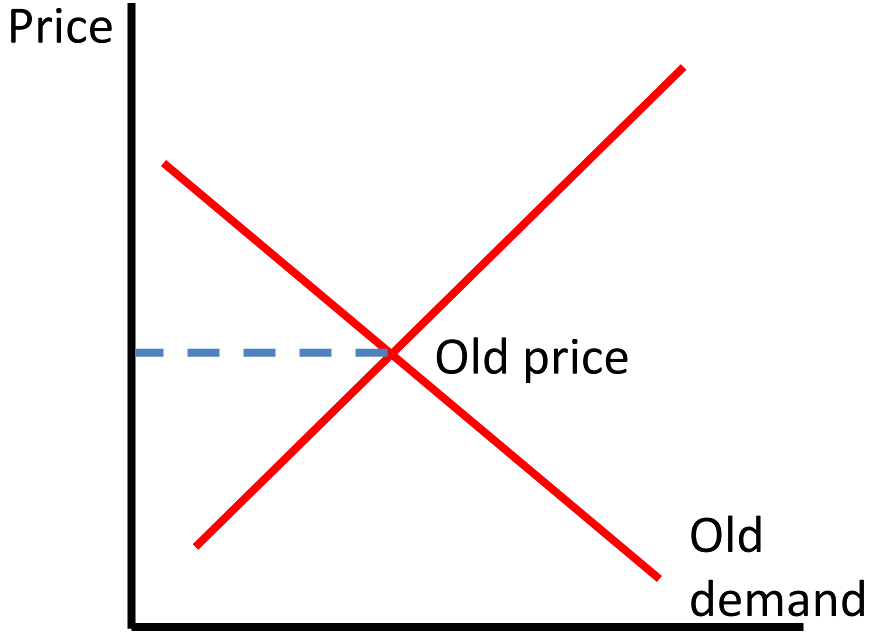

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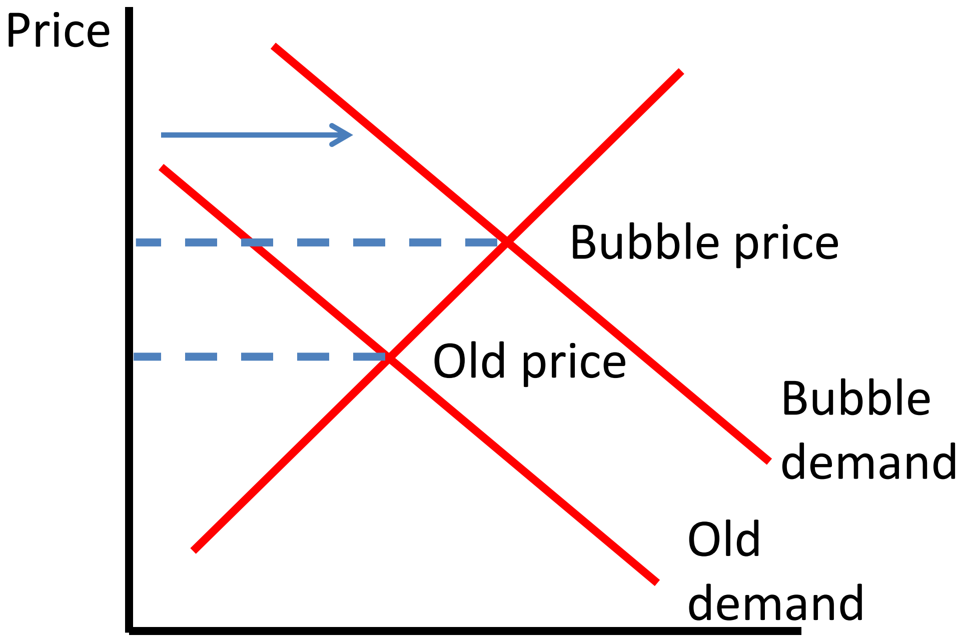

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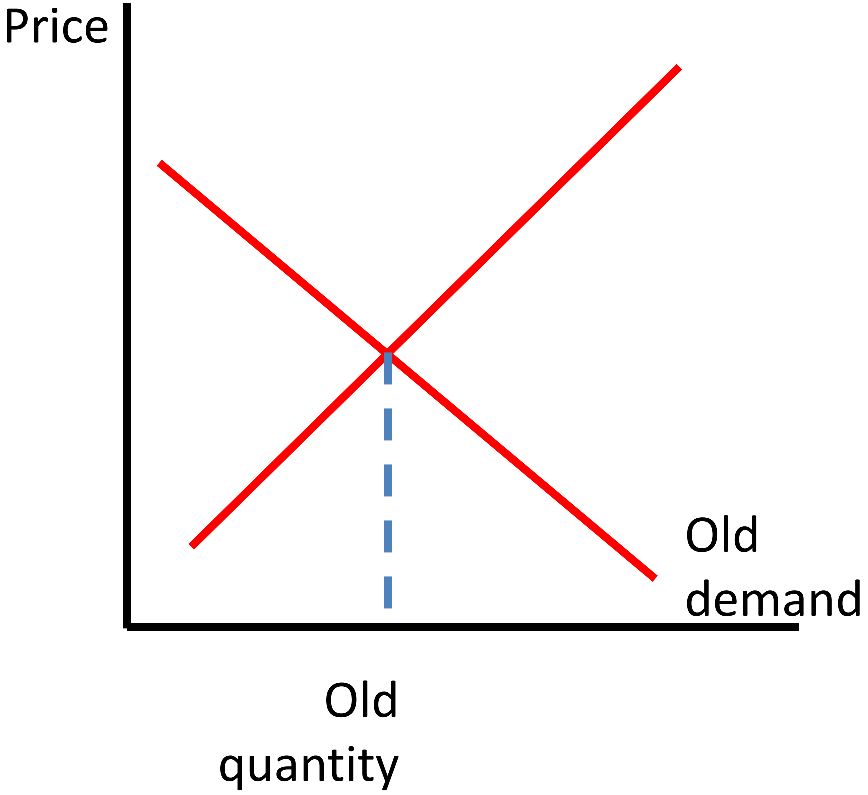

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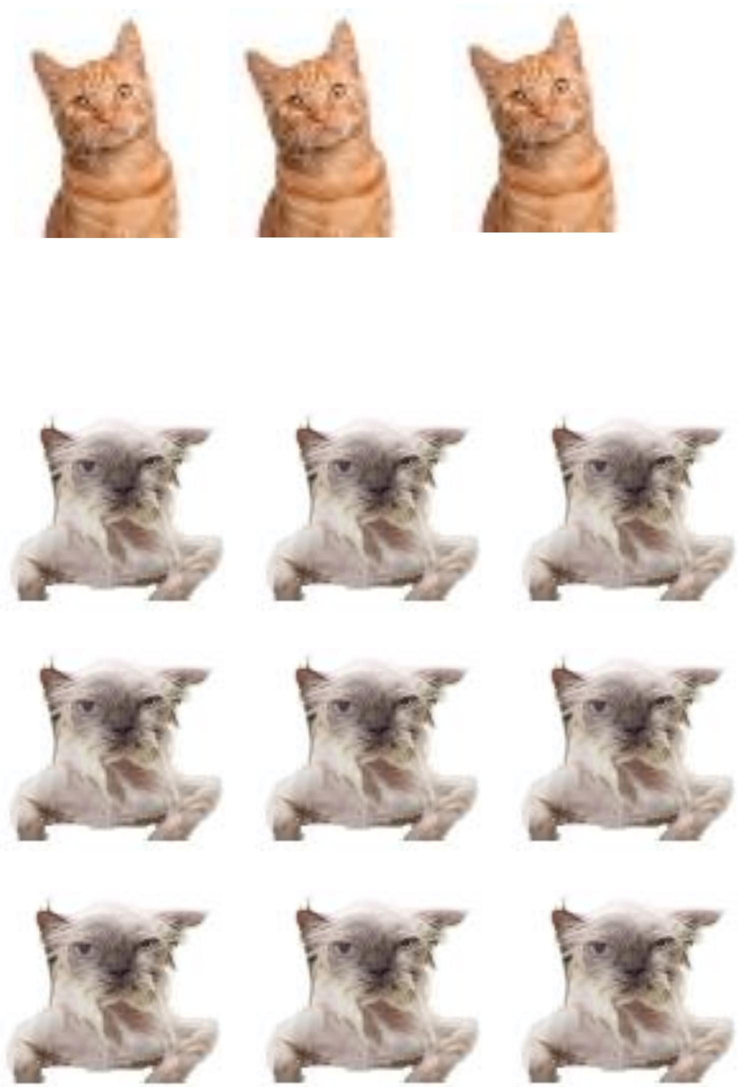

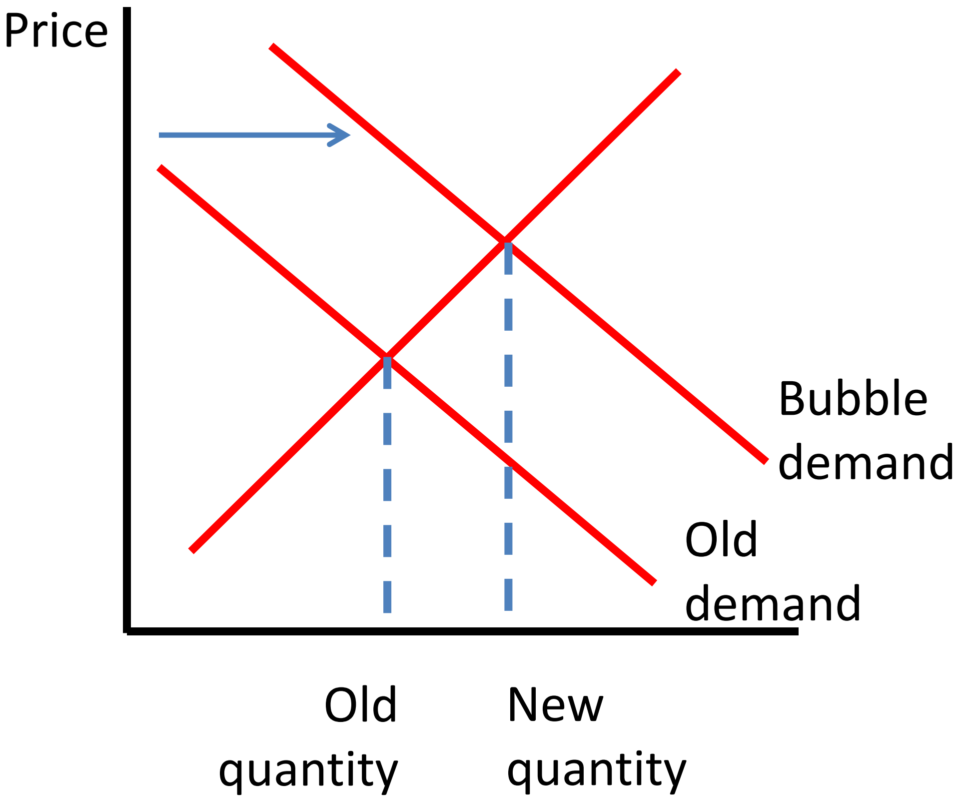

When does the bubble burst?

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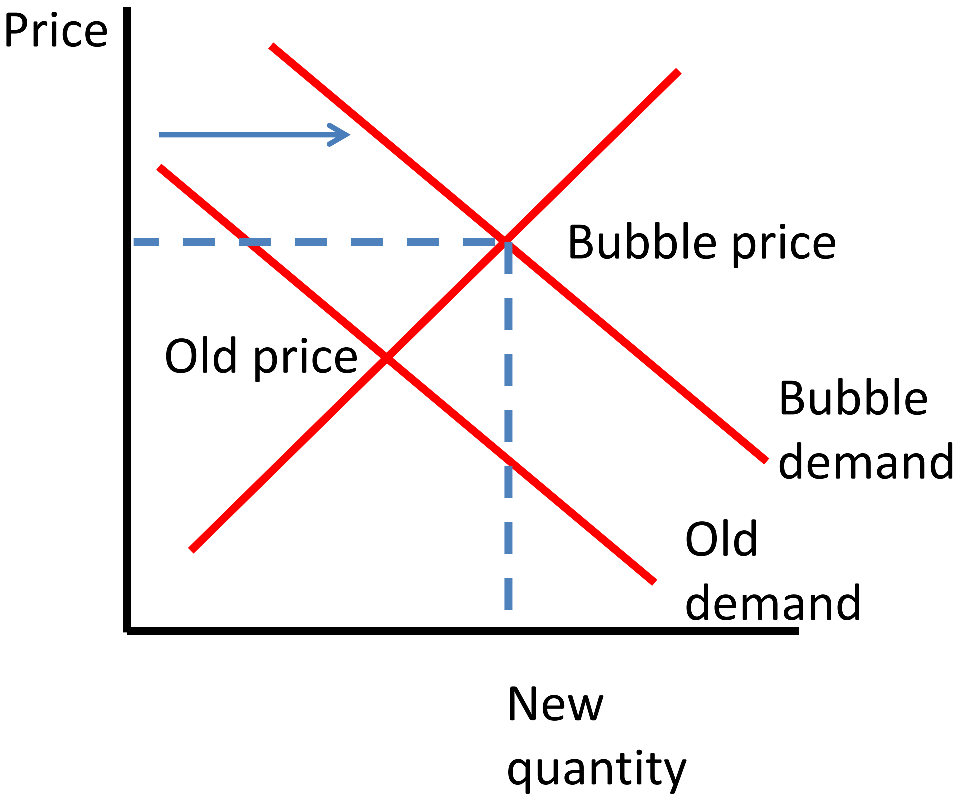

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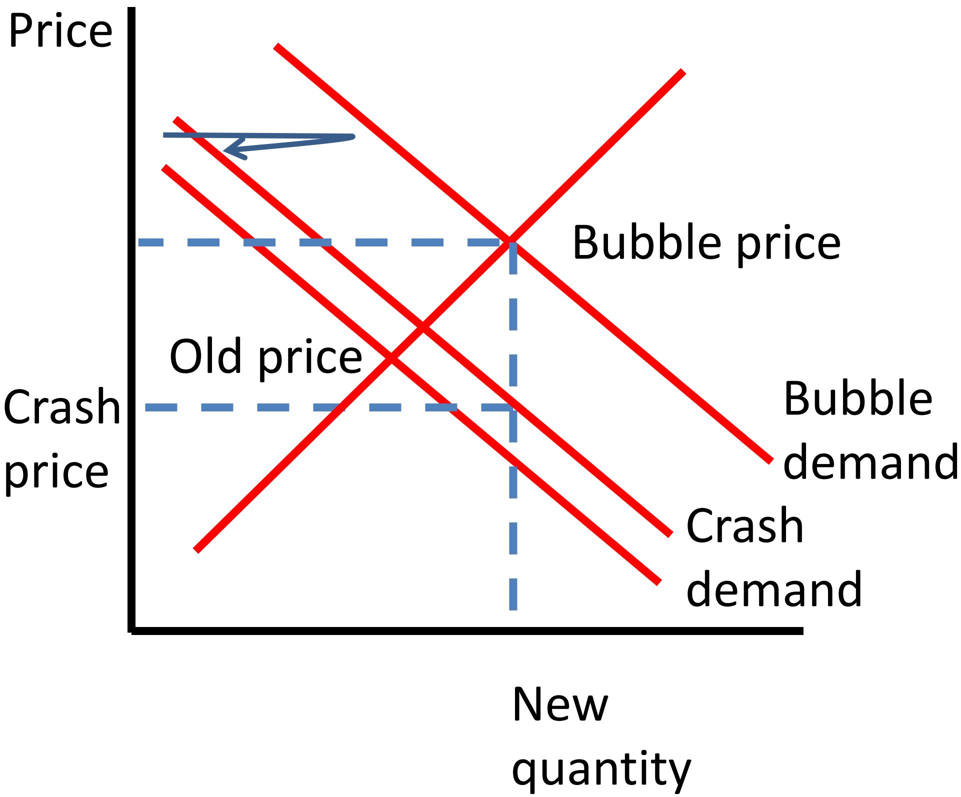


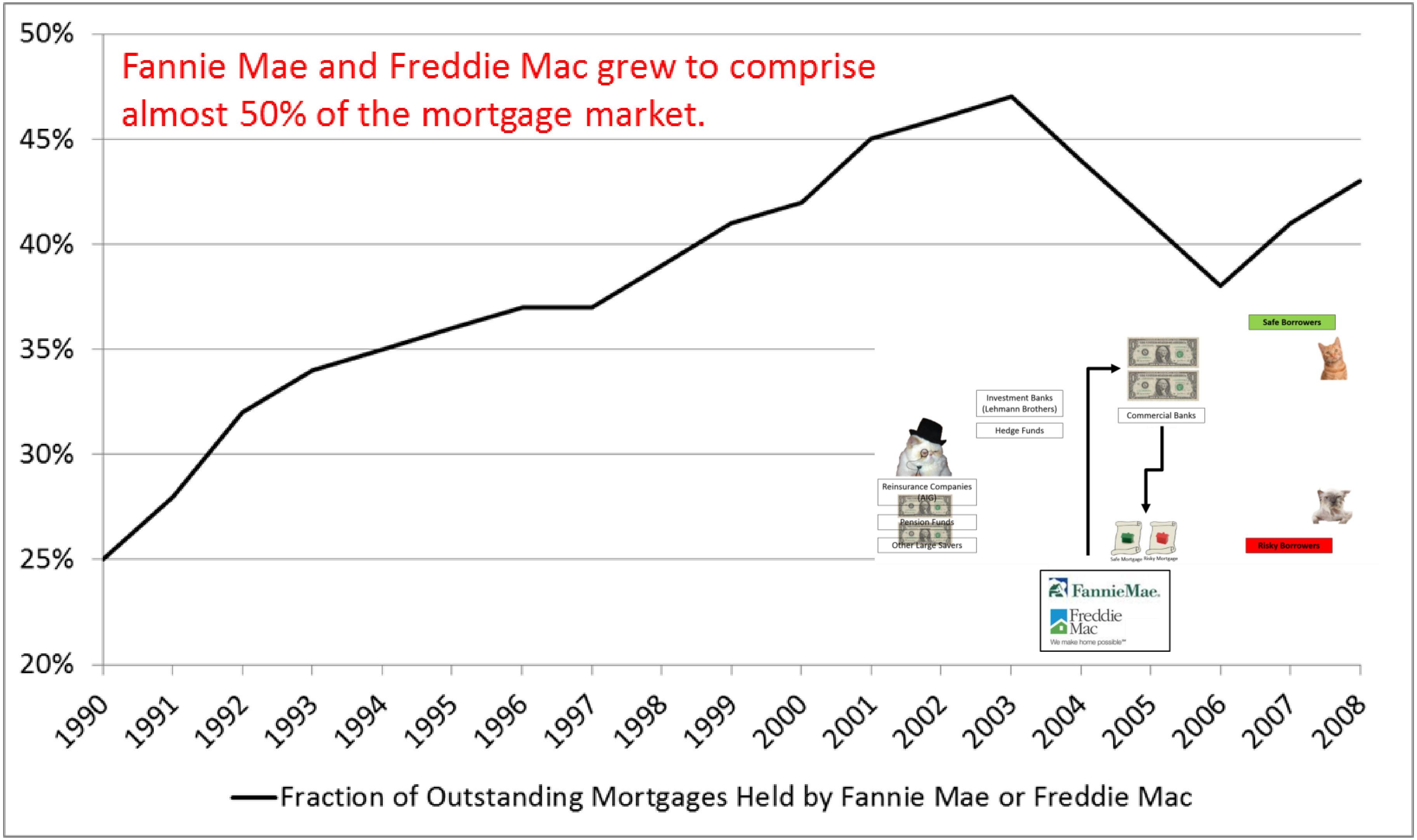
What happened?

Simple answer

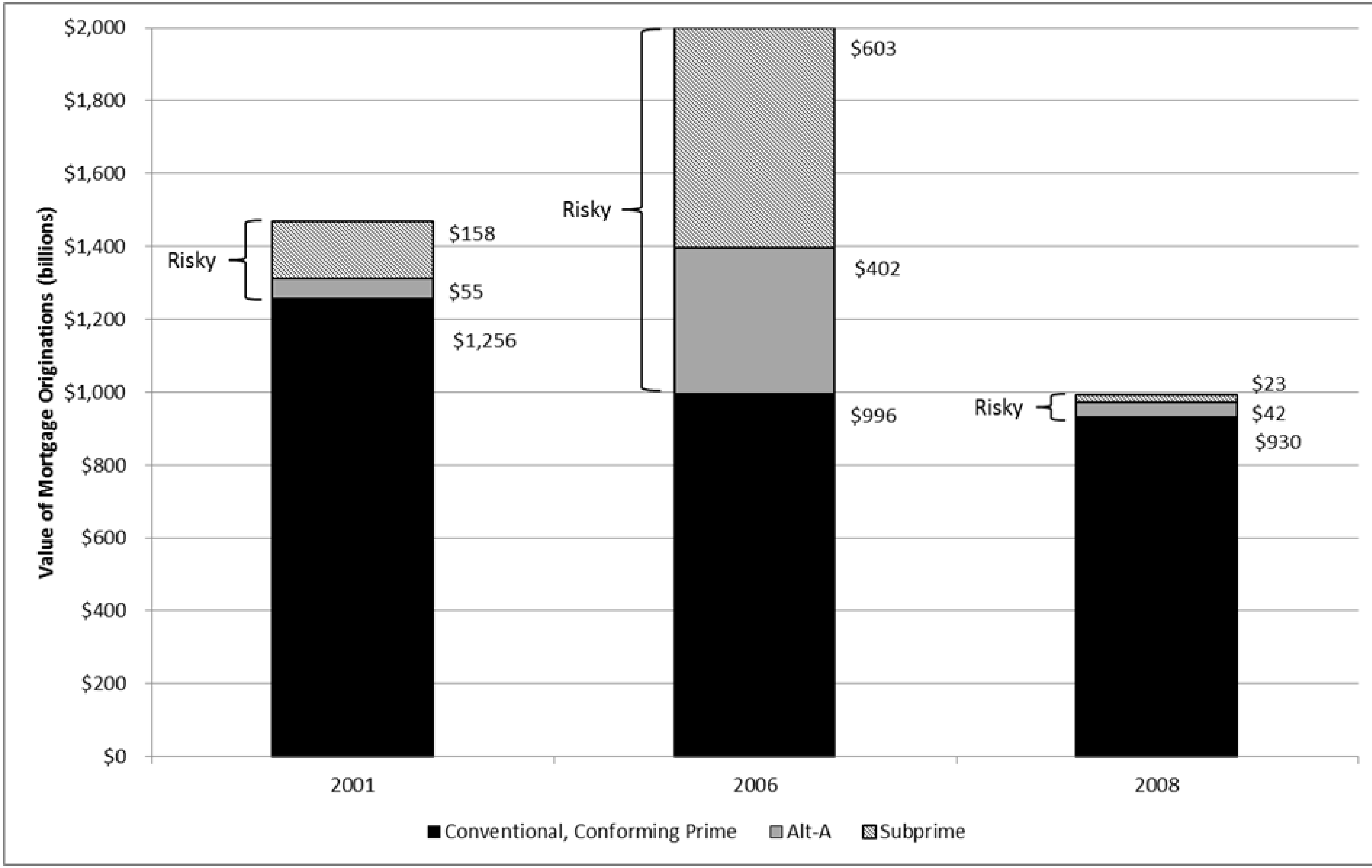
Government broke the link between risk and return...

<u>Detailed answer</u>

- Fannie Mae and Freddie Mac: taxpayers bear risk, but banks keep profit.
- Community Reinvestment Act (1977-1995): banks must provide loans to low-income and minority borrowers.
- Riegle-Neal Act (1994): regulatory approval of interstate bank mergers tied to Community Reinvestment Act ratings.
- HUD (1996): more than 40% of FM and FM loans must go to low-income borrowers.
- Taxpayer Relief Act (1997): exempts profits tax on home sales up to $500,000.
- Federal Reserve (2000 to present): holds interest rates low.



Source: Office of Federal Housing Enterprise Oversight, Senate Banking Housing and Urban Affairs Committee, 2/7/08



Source: Freddie Mac

What does this have to do with college loans?

Simple answer

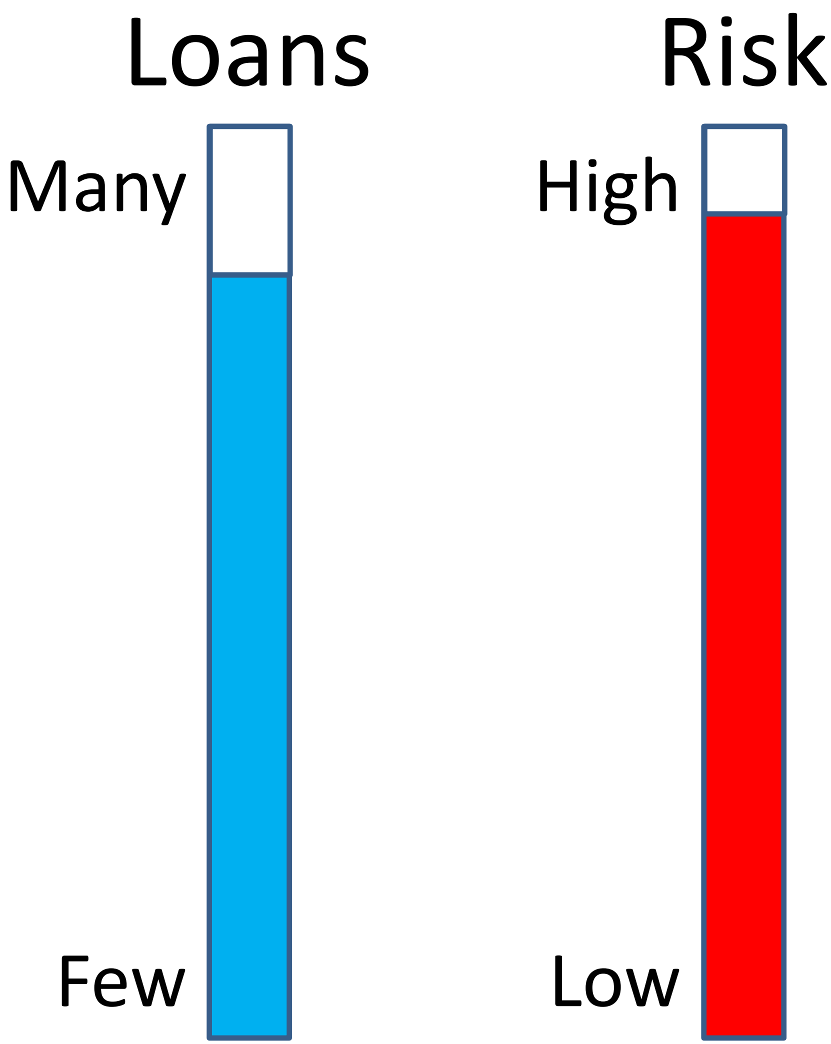
Government breaking the link between risk and return...

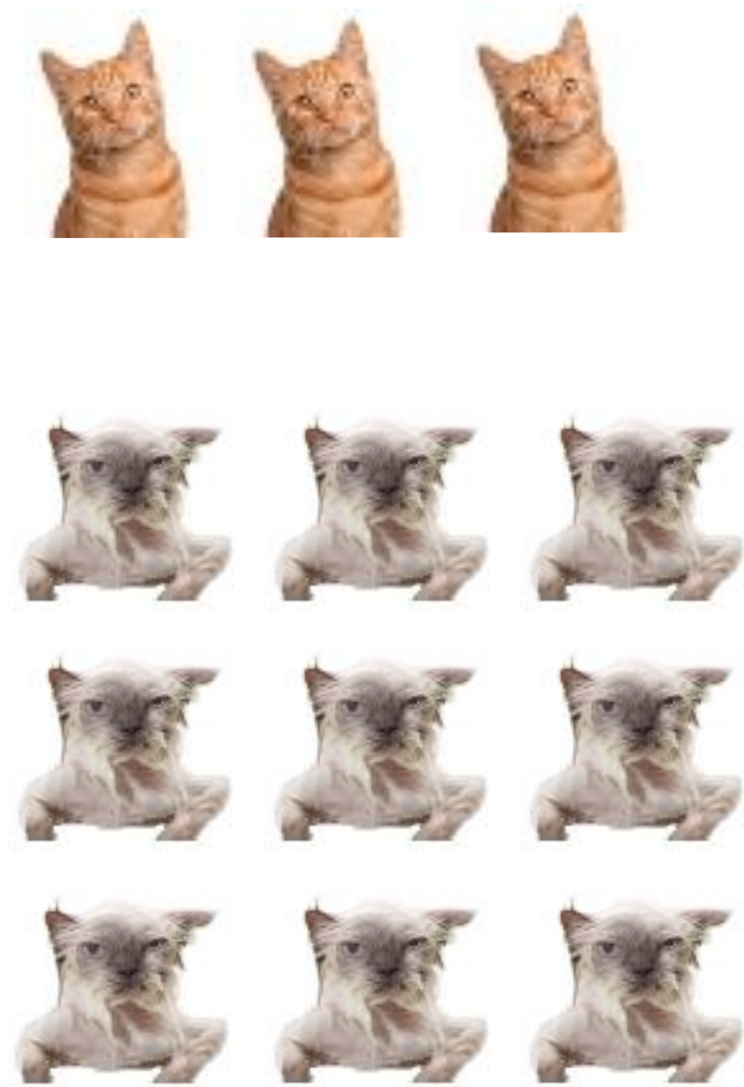
Detailed answer

- Stafford and Perkins loans: taxpayers subsidize loans.
- Taxpayer Relief Act (1997): tax credit for college debt.
- Affordable Care Act (2008): DoE loans directly to students.
- Loan Forgiveness Program (2014): forgive some federal student loans.
- Community College Act (proposed 2015): taxpayers pay for students to attend community college.
- Debt Forgiveness Act (proposed 2015): student loan debt be dischargeable in bankruptcy.
- Federal Reserve (2000 to present): holds interest rates low.

What are the consequences?

More college borrowing and risk.

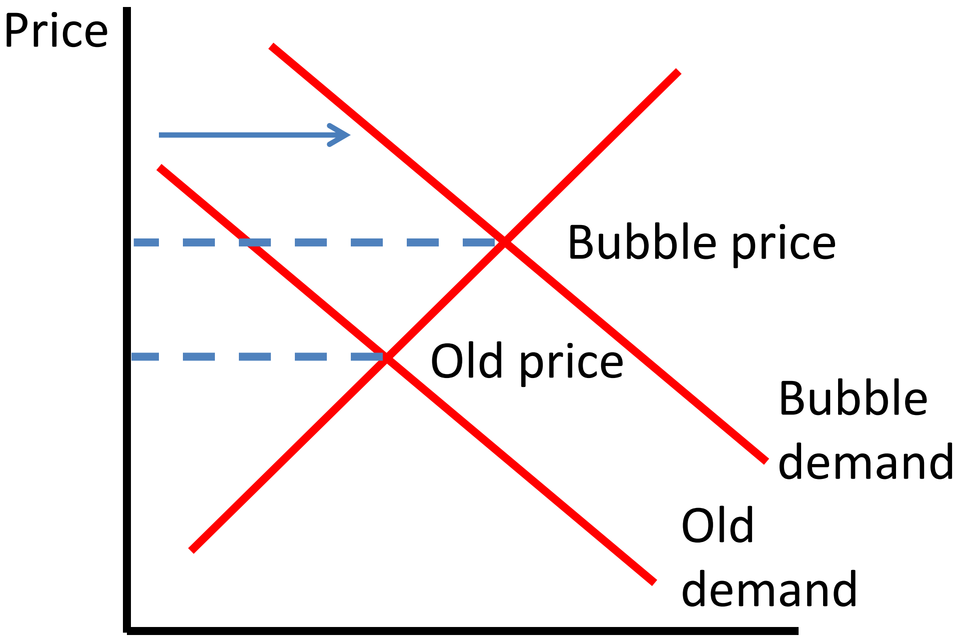




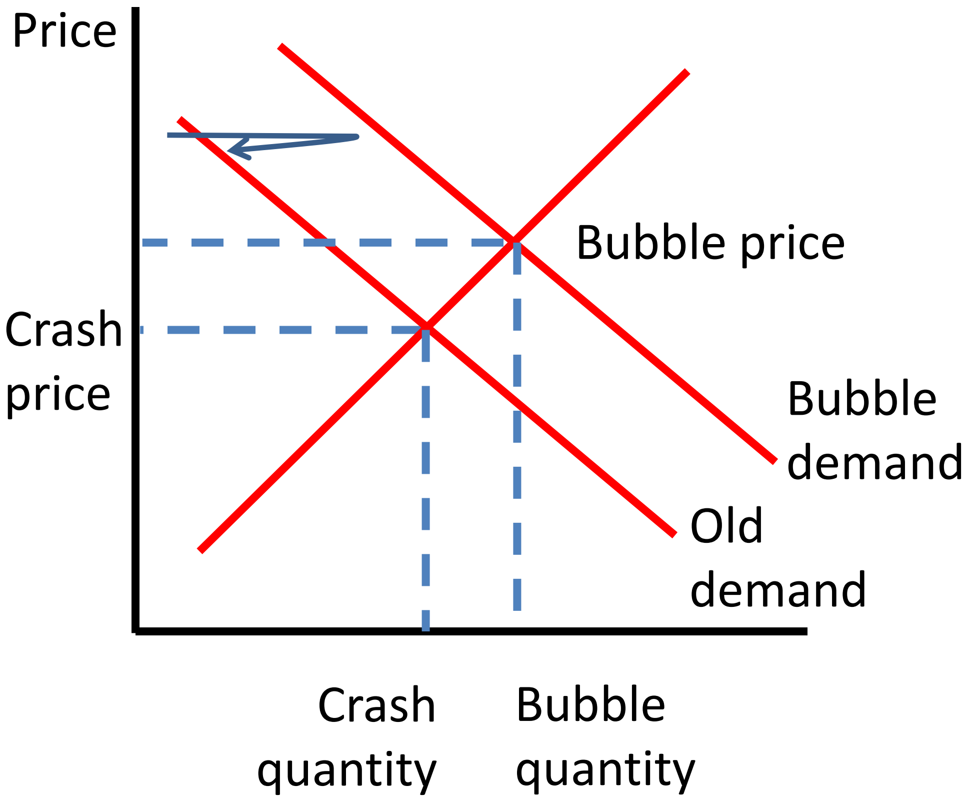
What do “high risk” student loan borrowers look like?

- Students who do not have the skills to succeed in college.
- Students who major in fields that have little earning power.

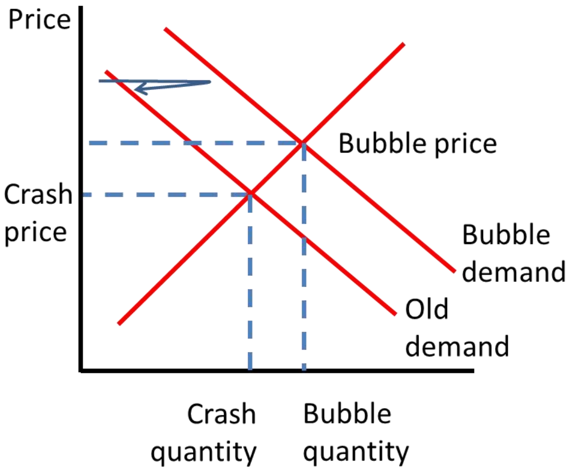
Current policies increase tuition costs.



Bubble bursts when students can't get jobs.

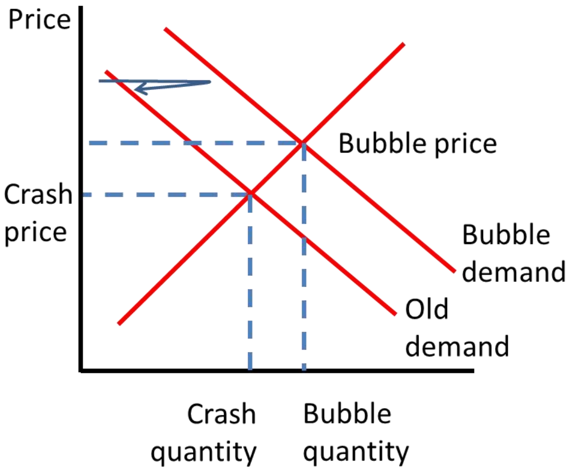


What happens when the bubble bursts?



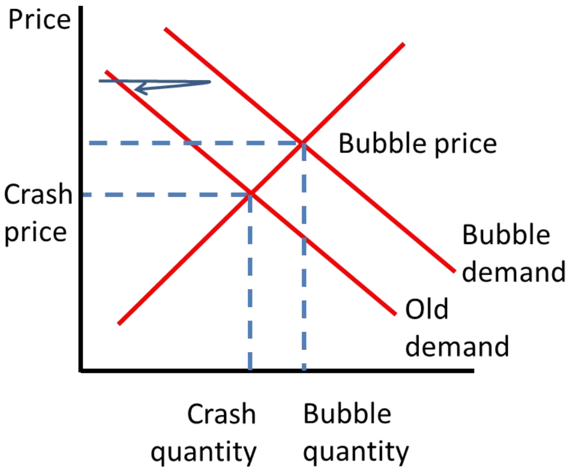
- Taxpayers get stuck with up to $1 trillion in debt (as of today).

- Millions of low-skilled students wasted four years.



- College presidents decried as “greedy” profit-seekers.

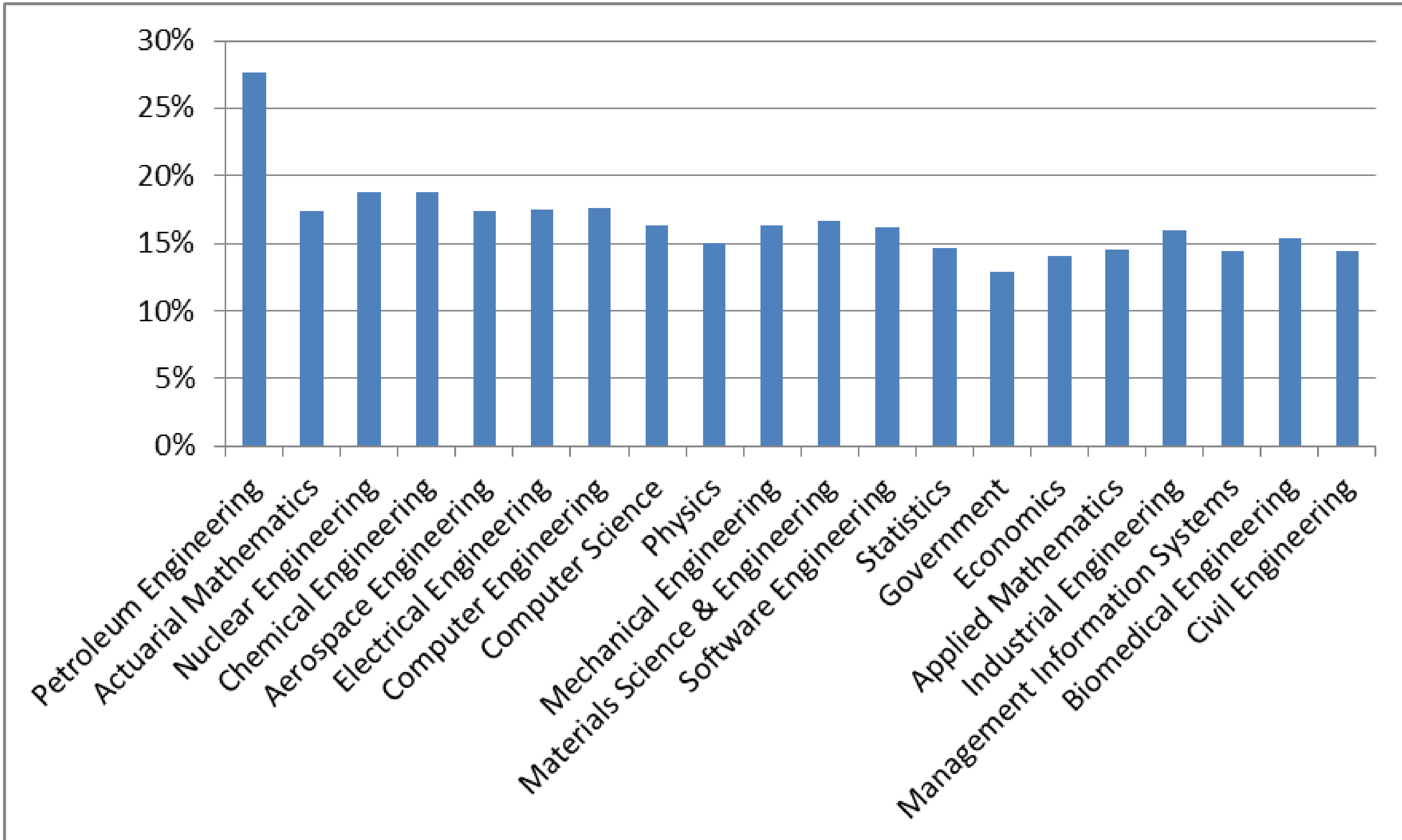
- Many small colleges go bankrupt.



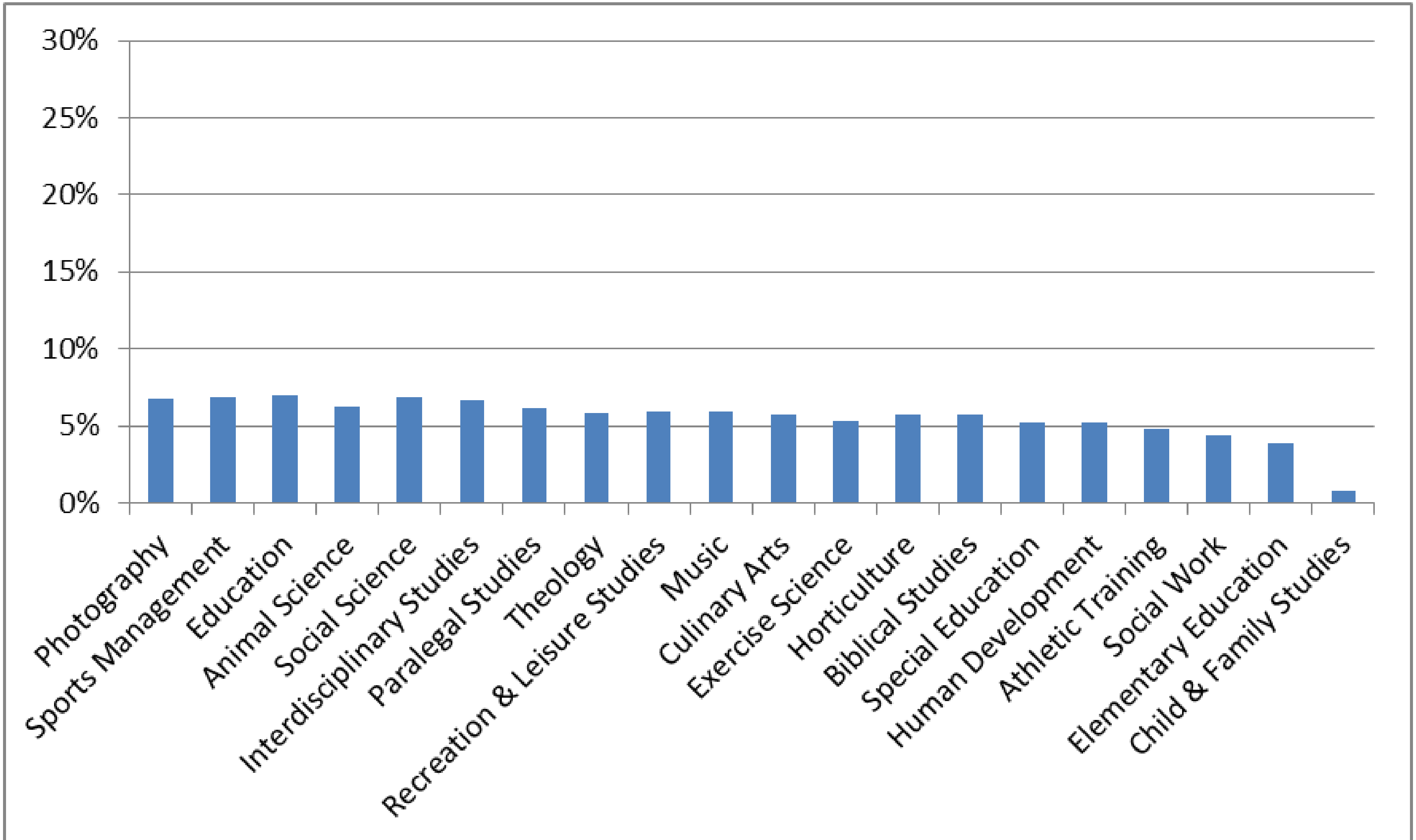
- Call for more government oversight of colleges and college loan markets.

- Call for nationalizing universities (Affordable College Act)

Real Rate of Return on a College Major
($200,000 investment)



Real Rate of Return on a College Major ($200,000 investment)



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Have we learned from our mistakes?

Stock market bubble (1990s)
Housing bubble (2000s)
College bubble (2010s)

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