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Federally backed student loans and mortgages are seeing increased defaults. Taxpayers are on the hook.



LIFE SCIENCE

The Credit Bubble Everybody's Ignoring

Rising defaults in private credit are rattling investors, while apparent fraud by some borrowers has fueled worries about lax underwriting. Investors are rushing to get their money out of funds to avoid getting stuck with big losses. Politicians are calling for—what else?—more regulation. w o w

But private-credit problems pale in comparison to the less-reported risks in federal student loans and mortgages, which could ripple through the economy. The Biden team's version of extend-and-pretend concealed the cracks for a time, but defaults are rapidly rising on government-backed loans. Taxpayers will inevitably be left holding the bag. Note

Start with student debt. Only 30% of the federal government's \$1.7 trillion student-loan portfolio is currently being repaid. Most borrowers are delinquent or their payments have been temporarily suspended while the Trump administration works to fix servicing problems caused by the Biden team's quasiforgiveness "SAVE" plan, which the courts blocked. Note

During the Biden payment pause, many borrowers upgraded their lifestyles and racked up more debt to pay for vacations, homes and cars. And why not? Joe Biden promised their loans would be forgiven. Note

"During the payment pause, borrowers repeatedly heard public signals suggesting student loan balances might be permanently reduced or eliminated," the left-leaning Urban Institute notes in a recent report. "Against that backdrop, some households may have felt reasonably equipped to take on auto loans, enter the housing market, or expand their use of other credit products." Note

The payment pause increased access to credit by temporarily improving credit scores of delinquent borrowers—on average by 103 points, according to one study. Low interest rates, pandemic government transfer payments and forbearance schemes at the same time made additional debt more manageable—at least for a time. Note

Credit scores also benefited from other government policies. In 2022, Fannie Mae instituted a "positive rent" initiative for landlords to report on-time rent payments—but not late or missed payments—to credit bureaus. Imagine if only A's went toward a student's final grade. Under political pressure, credit bureaus removed a large share of medical debt from borrower reports.

All of this made student-loan borrowers overextended, while also making them appear less risky to lenders. Among delinquent student borrowers, "38 percent now have an auto loan, up from 30 percent before the pandemic," the Urban Institute notes. "The share with a mortgage has nearly doubled, rising from 8 percent in 2019 to 15 percent in 2025." Note

But more borrowers have fallen delinquent on student and other debt since the payment pause ended in October 2024. "Student loan delinquency is increasingly intertwined with distress across other credit markets," the report says. Expect delinquencies to rise more when administrative forbearance ends in July for some eight million borrowers. Note

Meanwhile, delinquencies are mounting on Federal Housing Administration mortgages. The government backed loans to overextended and risky home buyers whose incomes have been squeezed by inflation. The share of FHA borrowers in

2024 with debt-to-income ratios exceeding 43%—generally considered risky—rose to 64%, up from 55% in 2019 and 36% in 2007. Note

Many FHA borrowers bought homes during the student-loan payment pause, which temporarily increased their financial liquidity. The \$500 a month they weren't paying on their student loans could go for a mortgage payment. Not savvy personal financing, but colleges don't teach that.

About 1 in 7 FHA loans originated between 2022 and 2025 defaulted within a year. As defaults mounted, the Biden team paid mortgage servicers to waive or reduce monthly payments of delinquent borrowers by 25% for up to three years. Missed or waived payments were added to the mortgage, which would have to be repaid when the loan matures. Note

So if a homeowner missed a \$3,000 mortgage payment for six months, a servicer would add the \$18,000 in missed payments, plus \$27,000 in payment reductions, to his loan. If home prices continued to increase, or mortgage rates dropped significantly, the Biden FHA figured borrowers could make up the forbore payments when they sold or refinanced. Note

That assumption proved wrong. Mortgage rates have remained high, and home prices in many markets in the South are falling amid crimped demand. The Biden FHA repeatedly waived payments for delinquent borrowers, only for them to default again. Increasing numbers have fallen underwater because they haven't built equity. Note

Some 55% of borrowers who received mortgage relief in 2024 fell behind again on payments within one year, according to an FHA report in December. "FHA is currently approaching a 60 percent redefault rate, which is unsustainable," the report noted. Some 46% of borrowers in default as of last September had previously defaulted at least three times. Note

One-sixth of borrowers who took out FHA mortgages in 2024 currently owe more than their home is worth. The Trump administration last fall restricted mortgage workouts to once every two years so foreclosures don't keep getting kicked down the road. As a result, foreclosures have shot up, which could push down home values in some markets, pushing more borrowers underwater. Note

If the economy slows, defaults on poorly underwritten government loans could spike. Unlike private credit investors, taxpayers won't be able to escape before the dirt hits the fan.

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