

# An Analysis of the Feasibility of an Illinois Pay It Forward Program

As Directed by Public Act 98-920

Report to the Illinois General Assembly

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Illinois Student Assistance Commission

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## Executive Summary

This report provides background and context for the proliferating Pay It Forward, Pay It Back (PIF) legislation seen across the country. It explains what a PIF program is, describes the mechanics of these programs, outlines the conditions that would need to be met for a program to be viable, and identifies the issues and questions that require resolution before a program could be implemented. It is written in response to House Bill 5323 – the Pay It Forward, Pay It Back Act - that requires the Illinois Student Assistance Commission to “undertake a study to determine the practical and fiscal impacts of adopting a program in Illinois similar to Pennsylvania’s Pay It Forward Pay It Back program.” The bill further requires that the “study shall focus on the particular intricacies, details, and mechanics of funding with specific regard to the proposal contained in the language of House Bill 5323 [the Pennsylvania Model] from the 98th General Assembly, as introduced.” The report also must include the results of a survey of similar programs in other states “with specific regard to funding and programmatic practicality and feasibility.” The important points of the report are detailed below.

- At least 24 states have proposed some form of PIF legislation within the past two years. At the core of these legislative initiatives is a desire to reduce the financial barriers to college attendance that potential students face by implementing a state-funded loan program in which payment size is adjusted according to the borrower’s income, or a contract for income sharing that allows students to defer paying for college until they join the workforce. These PIF programs usually tie the amount students ultimately pay for their education to the income they receive for a specified number of years after graduation. *To date, however, no state has implemented a PIF, even as a pilot program.*
- While actual program implementation has not occurred in any state, states’ interest in the idea has accelerated. The astonishing number and speed of these legislative proposals, despite some very serious design hurdles and cost barriers yet to be overcome by any state, is likely the result of a combination of factors: the rapidly rising cost of higher education in all sectors; the necessity of pursuing higher education to help insure a middle-class standard of living; the decline in the ability or inclination of the states to fund higher education; and the uncertain job market for college graduates which leaves students wondering if they ever will be able to pay off their student loans. PIF programs appear to provide a path to acquiring a postsecondary credential for those who are now finding paying for college difficult or impossible.
- Although PIF programs have generated much interest by legislators, there are many in the higher education community opposing PIF programs. While some critics offer up logistical problems and student to student cost shifting as reasons for their dislike, the most prevalent and fundamental reason for the considerable opposition to these programs is the belief that they will mask declining state support for higher

education and hasten the march toward the complete privatization of higher education. *These outcomes are not inevitable with a PIF program but any successful PIF program would have to provide safeguards to address these concerns.*

- The report describes the mechanics of a PIF program and the substantial political, legal and investment hurdles associated with these types of programs that must be overcome for a successful program to be implemented. PIF programs need to have an efficient financial instrument, either an Income Share Agreement (ISA) or an Income Based Repayment (IBR) Loan, and a workable set of program parameters that define eligibility requirements, identify the costs that can be deferred, detail an accounting methodology for tracking the deferred costs, develop repayment and collection procedures and identify a source or sources of initial funding.
- The issue of funding is critical. PIF programs require huge up-front costs by the state. To offer a PIF option to most public university and community college students in Illinois would require *billions of dollars in up-front costs from the state*. Under generous assumptions, it would be 20 years before the net revenue stream turns positive and many more years after that to recoup the initial investment. While other funding sources may be available at some point, such as public/private partnerships and utilizing a prepayment program for parents – a parent’s PIF - these types of resources would take years to develop and may never develop. In the short run, reallocation of existing funds, new tax revenues and bonds are the only reasonable options available. Bonding out the cost seems the most likely option but that would add additional costs to an already expensive program.
- The report describes some safeguards that would need to be in place to prevent some of the widely perceived negatives of a PIF program, specifically that it would increase the movement toward the privatization of public institutions and that it would shield schools from the impacts of further raising their tuition and fees. Assuming those safeguards are in place, a program was modeled using a consistent set of assumptions to illustrate how a PIF program might work in Illinois. The analysis indicates that it is possible in Illinois to design a PIF program with a 20-year break even point (the point at which the state no longer has to make *additional* contributions) and keep the PIF repayment percentages on income under 5%. It also provides a description of a pilot program that could be implemented to test the financing mechanism and determine the accuracy of some of the assumptions concerning school and student behavior that need to be made when forecasting participation in this type of program. It would also establish the workability of participant tracking and collection processes. However, it is critical that additional work be done with outside professionals in the areas of legal, tax, actuarial and systems development to understand all of the issues and to accurately determine the cost of implementing a PIF program.

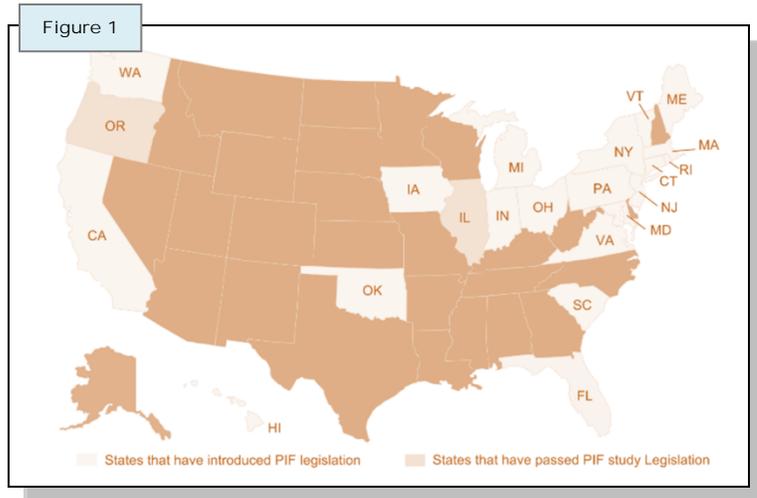
- The start up costs associated with a pilot program would be very high on a per participant basis since all of the operations necessary to run a full-scale PIF program would have to be in place. While the pilot program is only six years in length (the period of time where students are actually receiving a PIF), a least a year's lead time and more likely two years would be needed. Since services of attorneys, actuaries and other professionals would have to be procured and that procurement process can take nearly a year, the lead time needed could easily stretch to two years. A higher education trust fund would need to be set up to collect the payments from PIF participants and tracking and collecting methodologies would need to be developed. Payments from participants would need to be tracked and collected for twenty years after the project officially ends. In addition, the process of interacting with the schools related to making payment for students would have to be developed. *Adding the preparation time and the collection period to the actual PIF running time yields a "pilot" program that would take close to 30 years to complete.* While much of the information needed from that pilot would be obtained during the first ten years of operation, the program would still have to function until the last participants make their last payments.
- The protracted nature of a PIF pilot and the costs associated with it make running it only feasible if the intent is to institute the full-scale program. The biggest hurdle to running a full scale program is funding it. *Until a source of funding for a full-scale program has been identified, a pilot PIF program would appear to make little sense.*
- Policymakers should also take note that there are significant risks and uncertainties associated with the creation of a precedent-setting PIF pilot. The lack of any legal antecedents for a state-level PIF means that there are substantial questions unanswered regarding critical factors—such as taxation, bankruptcy, and collectability—affecting a PIF plan's ultimate success. Without clarity in these areas, there is real risk that a program could run into stumbling blocks in attracting program participants, securing adequate initial funding, attracting private investment (if using a public/private funding model), and ultimately achieving a self-sustaining system. Federal legislation that has been proposed but not yet passed in the current Congress could address a number of these issues, but as yet PIFs must be said to occupy a legal gray area.
- Finally, PIF programs have been billed in the media as essentially providing a way to make college "free." *PIF program are not the path to free higher education. They are deferred income payment plans that require repayments by participants that extend decades into the future.* The up-front costs that are being deferred by students have to be paid initially by the state at a cost of billions of dollars in addition to the state funding already provided. PIF programs may ultimately turn out to be a better way to pay for college, but they do not make college free for anyone.

In addition to the report, there is an appendix containing the origins and history of what are now called Pay It Forward programs (Appendix II), an appendix containing frequently asked questions (FAQs – Appendix I) about these programs, appendices describing other state initiatives (Appendix III) and federal legislation (Appendix IV), and a bibliography of all materials consulted (Appendix X). ISAC has established a PIF resources web page that contains the bibliography with links to the materials used. We also have encouraged comments and suggestions from those in the higher education community, existing private income share agreement providers and other interested parties. We have incorporated some of their comments into the report and all comments can be found in Appendix IX.

The legislation requiring us to produce this report did not ask for recommendations. There are strong opinions, both positive and negative, about PIF programs. This report attempts to describe the issues of concern and to show a pathway to the establishment of PIF program if funding can be found. Although a selection of program components had to be chosen to develop the fiscal estimates and address the mechanical issues (through a pilot program), the report does not recommend any particular course of action.

## Introduction: The Pay It Forward Movement

At least 24 states have proposed some form of Pay It Forward/Pay It Back (PIF) legislation within the past two years. At the core of these legislative initiatives is a desire to reduce the financial barriers to college attendance that potential students face by implementing a state-funded Income Driven or Income Based Repayment Loan (IDR/IBR) Program or a Human Capital Contract ((HCC) also called an Income Share Agreement (ISA)) that



allows students to defer paying for college until they join the workforce. These PIF programs tie the level of periodic loan repayments, and often the amount students ultimately pay for their education, to the income they receive for a specified number of years after graduation.<sup>1</sup> Variations of Pay It Forward have operated at the federal level in Australia and other countries for years and today small, private HCC/ISA programs are operating in the U.S., South America and elsewhere. While many states now have proposed some type of PIF legislation, most are proposing very modest steps toward implementing a PIF program such as a feasibility study or a small pilot program. The reason for “baby steps” is clear: A full-blown Pay It Forward program available to all potential students in a state is an expensive and complicated proposition. *To date, no state has implemented a PIF, even at the pilot stage.*

While actual program implementation has not occurred, states’ interest in the idea has accelerated. The astonishing number and speed of these legislative proposals, despite some serious design hurdles and cost barriers yet to be overcome by any state, is likely the result of a combination of factors: the rapidly rising cost of higher education in all sectors; the perceived necessity of pursuing higher education to help insure a middle-class standard of living; the decline in the ability or inclination of the states to fund higher education; and the uncertain job market for college graduates which leaves students wondering if they will be able to pay off their loans. PIFs’ philosophical appeal to legislators on both sides of the aisle could also be a factor: “Left-leaning advocates believe PIF could further open the doors of college opportunity for low-income students by eliminating a major barrier to entry and keeping student debt manageable through wealthier

<sup>1</sup> Programs designed to implement human capital contracts or large IDR programs at the state and federal level have come to be known as Pay It Forward (PIF) programs, based on the name of the initial program put forth by Oregon in 2012 as “Pay It Forward, Pay It Back.” The concept came from a Portland State University student capstone project based on a report from a Washington State research group. The Oregon state legislature passed a bill to study the concept, called “Pay it Forward, Pay it Back” in FY2013. The shorter name “Pay it Forward” has been broadly used since then to identify these types of financing mechanisms.

graduates subsidizing those with lower post-college earnings. Right-leaning PIF supporters believe the policy change could introduce market dynamics into college financing and ultimately eliminate taxpayer subsidies to public colleges – essentially privatizing public higher education.”<sup>2</sup> Pay It Forward proposals are seen as ways to minimize the impact of declining state support and increasing tuition burdens by providing some insurance to students that pursuing their education goals will not lead to crushing debt upon graduation.

While Pay It Forward programs have generated much interest by legislators, there are many in the higher education sector opposing PIF programs. While some critics offer up logistical problems and student to student cost shifting as reasons for their dislike, the most prevalent and fundamental reason for the considerable opposition to these programs is the belief that they will mask declining state support for higher education and hasten the march toward its complete privatization. Any workable PIF program would have to address these concerns.

This report provides some background and context for the proliferating PIF legislation. It describes the mechanics of a Pay It Forward program, outlines the conditions that would need to be met for the program to be viable, and identifies the issues and questions that require resolution before even a pilot program could be implemented. It is written in response to House Bill 5323 – the Pay It Forward, Pay It Back Act which requires the Illinois Student Assistance Commission (ISAC) to “undertake a study to determine the practical and fiscal impacts of adopting a program in Illinois similar to Pennsylvania’s Pay It Forward Pay It Back program. The bill further requires that the “study shall focus on the particular intricacies, details, and mechanics of funding with specific regard to the proposal contained in the language of House Bill 5323 [the Pennsylvania model] from the 98th General Assembly, as introduced.” The report also must include the results of a survey of similar programs in other states “with specific regard to funding and programmatic practicality and feasibility.” The remainder of the report addresses these requirements. A summary of the survey data of other states is provided in Appendix III-B.

## Putting Pay It Forward Programs in Context

Achieving a postsecondary credential is becoming more difficult in Illinois and across the country. While the majority of Illinois residents now perceive the need for higher education, they often find the process of obtaining a degree or credential to be too difficult, too long, and, especially, too expensive. Uncertainty about employment after graduation exacerbates the situation creating concerns not only about acquiring large amounts of debt but the ability to ever pay it off.

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<sup>2</sup> *The “Pay It Forward” College Financing Concept: A Pathway to the Privatization of Public Higher Education* by Thomas L. Harnisch. American Association of State Colleges and Universities, July 2014. A Policy Matters: A Higher Education Policy Brief. [www.aascu.org/policy](http://www.aascu.org/policy)

## Rising College Costs, Rising Student Loan Debt Levels and Changing College-Going Behavior

Twenty years ago, a student in Illinois attending a public university paid \$3,303 per year for tuition and fees (Figure 2). A student lucky enough to receive a MAP grant attended for free as the maximum MAP grant, \$3,800, fully covered the cost of tuition and fees. In addition, he was likely to receive a Pell grant of \$2,300 to help with living expenses.<sup>3</sup> Middle income families didn't receive the state and federal grant aid, but the \$3,303 tuition bill was about 8% of the median family income of \$44,220.<sup>4</sup> Student jobs, family savings and relatively small student loans made up any shortfall. College in Illinois was affordable; in 2000, The Higher Education Report Card gave Illinois an "A" in affordability, one of only two states to receive that designation. By 2008, the last year of the report, the grade had decreased to an "F."<sup>5</sup> Affordability has not improved in Illinois since 2008.



**College Cost Scenario**

Twenty Years Ago...	Today...
<p><b>Average Illinois Public University Tuition and Fees:</b> \$3,303</p> <p><b>Maximum Monetary Award Program (MAP) Grant:</b> \$3,800</p> <p><b>Maximum Pell Grant:</b> \$2,300</p> <p><i>* The very lowest-income student could attend for free and have help with living and other education-related expenses.</i></p> <p><b>Median Income for Middle-Income Families:</b> \$44,220</p> <p><i>* Middle-income families didn't receive state and federal grant aid, but tuition and fees represented only about 10% of their family income. Student jobs, family savings and relatively small student loans made up any shortfall. The Higher Education Report Card gave Illinois an "A" in affordability, one of only two states to receive that designation.</i></p>	<p><b>Average Illinois Public University Tuition and Fees:</b> \$13,382</p> <p><b>Maximum Monetary Award Program (MAP) Grant:</b> \$4,720</p> <p><b>Maximum Pell Grant:</b> \$5,730</p> <p><i>* The very lowest-income student cannot cover tuition and fees, and that is before buying books and paying for transportation and living expenses.</i></p> <p><b>Median Income for Middle-Income Families:</b> \$56,853</p> <p><i>* For middle-income families, tuition and fees alone represent nearly a quarter of their annual income before taxes. They receive no state or federal grant aid. With the cost of books and room and board, they are facing bills of about \$25,000 per year.</i></p>

<sup>3</sup> 2004-05 Federal Pell Grant Program End-of-Year Report, U.S. Department of Education 2005.

<https://www2.ed.gov/finaid/prof/resources/data/pell0405.pdf>

<sup>4</sup> <https://www.census.gov/hhes/www/income/data/statistics/4person.html>

<sup>5</sup> *Measuring Up 2008: The Higher Education Report Card*. The National Center For Public Policy and Higher Education. <http://measuringup2008.highereducation.org/>

Today the average tuition and fees at a public university is \$13,382 in Illinois<sup>6</sup>. The maximum MAP grant, at \$4,720 now covers only a third of tuition and fees for students from lower-income families, leaving them to find over \$8,500 *before* buying books and paying for transportation and living expenses. For middle income families, with a median income of \$56,853 that \$13,382 represents nearly a quarter of their annual income before taxes. They receive little state or federal grant aid. With the cost of books, transportation and room and board, they are facing bills of about \$25,000 per year. A bachelor's degree at a public university now costs over \$100,000, *if it is completed in four years*. Many students take five or more years, significantly increasing the costs.

The result is changing college attendance behavior in the form of lower initial attendance rates<sup>7</sup>, fewer classes attempted<sup>8</sup>, periodic cycling in and out of school<sup>9</sup> and longer time to degree<sup>10</sup>. Those who attempt college are facing mounting student loan debt, both in Illinois and nationally. "Because college costs have risen faster than family incomes and available grant aid, student loans have become a fact of life for more Americans than ever before. Nationally, less than half of four-year college graduates had loans in 1993. By 2012, over \$1 trillion dollars of student loan debt was carried by more than 40 million borrowers."<sup>11</sup> About 69% of students had loans, and those who borrowed owed an average of \$28,400 at graduation.<sup>12</sup> Among undergraduates at all types of schools, federal Pell Grant recipients – who typically have family incomes under \$40,000 – were

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<sup>6</sup> ISAC calculation based on information provided by the colleges annually to ISAC. Based on a 16 hour semester budget and includes all mandatory fees paid by all students.

<sup>7</sup> For the first time in 20 years, dependent student FAFSA filing rates fell in FY2015. ISAC analysis of FAFSA data.

<sup>8</sup> For MAP recipients, both the percentage of students claiming awards and the percent of the dollars claimed are falling. The percent of dollars claim has fallen more than the percent of students claiming indicating that not only are fewer students claiming awards but the number of attempted hours of those that do claim is falling as well.

<sup>9</sup> *Transfer and Mobility: A National View of Pre-Degree Student Movement in Postsecondary Institutions*, published by the National Clearinghouse in partnership with Indiana University's Project on Academic Success, 2012. Report finds that about one-third of all students change institutions at least once.

<sup>10</sup> *Increasing Time to Baccalaureate Degree in the United States*, by John Bound, Michael F. Lovenheim, Sarah Turner, National Bureau of Economic Research Working Paper No. 15892, April 2010. "Time to completion of the baccalaureate degree has increased markedly in the United States over the last three decades, even as the wage premium for college graduates has continued to rise. ... we find evidence that the increases in time to degree were more marked amongst low income students. We consider several potential explanations for these trends. First, we find no evidence that changes in the college preparedness or the demographic composition of degree recipients can account for the observed increases. *Instead, our results suggest that declines in collegiate resources in the less-selective public sector increased time to degree.* Furthermore, we present evidence of increased hours of employment among students, which is consistent with students working more to meet rising college costs and likely increases time to degree by crowding out time spent on academic pursuits."

<sup>11</sup> Federal Reserve Bank of New York, 2013. [www.newyorkfed.org/studentloandebt/](http://www.newyorkfed.org/studentloandebt/)

<sup>12</sup> The Institute for College Access and Success (TICAS), *Student Debt and the Class of 2013*. November 2014. <http://projectonstudentdebt.org/files/pub/classof2013.pdf>. Calculations by TICAS using data from the U.S. Department of Education, 2013 National Postsecondary Student Aid Study (NPSAS). Figures reflect the annual borrowing of undergraduates who were citizens or permanent residents and attended colleges in the 50 states or the District of Columbia.

more than twice as likely as other students to take out a loan in 2012.”<sup>13</sup> Illinois students, facing some of the highest public university tuition and fees in the country<sup>14</sup>, are higher than average in the percentage of students with debt and about average for total debt accumulated<sup>15</sup>, with the percentage of college graduates with loans now at 70% with an average cumulative debt level of \$28,543.<sup>16</sup>

In addition to increasing debt levels, increased difficulty repaying loans has also been observed. The much talked about problem of three-year student loan cohort default rates at a high of 14% obscures an additional problem – 30% of loan repayers are now at least 90 days delinquent on their payments<sup>17</sup> and others who are making their payments are doing so with great difficulty. Another group of borrowers are in a hardship deferment.<sup>18</sup> Both total debt levels and debt repayment issues are important but they are distinct issues. Borrowers who are having the most difficulty repaying are not always the borrowers with the highest debt levels. “Borrowers who default carry nearly half as much debt as the average borrower.”<sup>19</sup> Students who graduate have higher debt levels but have a better chance of securing a job that allows them to make the payments. Students with lower debt levels often have not finished and therefore don’t obtain the benefits of a college degree when competing in the job marketplace. Students often drop out because of financial issues; that behavior then leads to further economic distress down the road when they can’t make their loan payments.

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<sup>13</sup> *Can Income-Driven Repayment Policies be Efficient, Effective, and Equitable?* By Nicholas W. Hillman and Jacob P.K. Gross, April 2014. [www.lumina.org](http://www.lumina.org). “Even with the recent expansion of the Pell Grant, the maximum award covers less than 75 cents for every \$1 charged in public four-year college tuition and fees” from Congressional Budget Office data, 2013. In Illinois, combining the maximum Pell Grant and the maximum MAP grant provides about 80% coverage of average tuition and fees at a public university.

<sup>14</sup> *Trends in College Pricing*, The College Board, November 2014. Average tuition and fees at IL public universities is about \$12,250 compared with the national average of \$8,893. We have the 5th highest state average public university tuition and fees in the country behind VT, NH, PA and NJ. We have the fourth highest flagship tuition and fees at \$14,750. The College Board average tuition and fee estimate differs from ISAC’s calculations. The CB number is used here for comparison with other CB numbers. Calculations can differ based on number of attempted hours and fees included. ISAC’s calculated numbers are somewhat higher.

<sup>15</sup> Likely because of MAP grants and large numbers of students attending lower-cost community colleges. The MAP grant reduces tuition and fee costs by a third or more and at 42%, Illinois has one of the highest levels of students at community colleges, above the national average of 34% (FY2010)

<sup>16</sup> *Student Debt and the Class of 2013*, The Institute for College Access & Success and The Project of Student Debt, November 2014. <http://projectonstudentdebt.org/files/pub/classof2013.pdf>

<sup>17</sup> *Direct Loan Portfolio by Delinquency Status, FFY2014, Quarter 3*, U.S. Department of Education Federal Student Loan Portfolio. <https://studentaid.ed.gov/about/data-center/student/portfolio>

<sup>18</sup> As of June 30, 2014, 51% of borrowers are not paying their loans on time. 15% were in forbearance, 18% either delinquent or in default; 1% bankruptcy or disability; and 18% in deferment. Department of Education data produced in a graph in *These 9 Charts Show America's Coming Student Loan Apocalypse* by Shahien Nasiripour, August 20, 2014. [http://www.huffingtonpost.com/2014/08/20/student-debt-distress\\_n\\_5682736.html](http://www.huffingtonpost.com/2014/08/20/student-debt-distress_n_5682736.html)

<sup>19</sup> *Can Income-Driven Repayment Policies be Efficient, Effective, and Equitable?* By Nicholas W. Hillman and Jacob P.K. Gross, April 2014. [www.lumina.org](http://www.lumina.org). This study reviewed other studies and summarized the predictors of default: unemployed after college, not completing a degree and attending a for-profit college are the best predictors of default, not cumulative debt level.

## *Uncertain Future for Graduates*

The increased necessity of some form of postsecondary education coupled with rising costs and rising student debt levels would be enough to create a significant problem for the state. But coupled with these problems has been persistent slow economic growth where jobs have been scarce. Although students with quality postsecondary credentials still fare far better in the job market than those without,<sup>20</sup> many workers with new degrees are either unemployed upon graduation or are accepting positions that result in underemployment at salaries that are unexpectedly low.<sup>21</sup> The nearly guaranteed job with the higher wage associated with completing postsecondary education is not as assured as it was, making the prospect of repaying significant student loan debt upon graduation even more troubling.

The combination of rapidly increasing costs of higher education coupled with diminishing returns (or at least diminishing certainty of those returns) has legislators, educators and families across the country scrambling for a solution. In Illinois, the high cost of college resulting in high debt levels for students facing an uncertain job market is creating a roadblock to achieving the state goal of 60% of the Illinois workforce obtaining a quality postsecondary credential by 2025. A question is being asked in Illinois and across the country: Can at least a partial solution to these problems be found in Pay It Forward programs?

## **What Are Pay It Forward (PIF) Programs?**

A PIF program may help students attend college by utilizing either an income-based repayment loan (IDR/IBR) or an income share agreement (HCC/ISA) allowing students to defer paying for college until they join the workforce. These programs usually tie the amount students ultimately pay for their education to the income they receive during a specified number of years after graduation. IDR/IBRs are loans where the borrower's payments are based on post-graduation income. They can be structured several different ways. Some are for a fixed number of years and include loan forgiveness. Other agreements specify no fixed number of years of repayment with the borrower continuing to make payment until the loan is paid off. Interest changes can vary from no interest (usually some sort of fee is assessed) to market rates. The proposed Pennsylvania Pay It

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<sup>20</sup> An analysis by the New York Federal Reserve "demonstrates that benefits of both a bachelor's degree and an associate's degree still tend to outweigh the costs, with both degrees earning a return of about 15% over the past decade." "Do the Benefits of College Still Outweigh the Costs?" By Jaison R. Abel and Richard Deitz, *Current Issues In Economics and Finance*, Volume 20, Number 3, 2014. New York Federal Reserve. [http://www.newyorkfed.org/research/current\\_issues/ci20-3.pdf](http://www.newyorkfed.org/research/current_issues/ci20-3.pdf)

<sup>21</sup> Abel, Jaison R., et al, *Are Recent College Graduates Finding Good Jobs?* "...both unemployment and underemployment have followed a clear upward trend for recent college graduates over the past two decades, and particularly since the 2001 recession. In addition, it has become more common for underemployed college graduates to find themselves in low-wage jobs or to be working part-time." The statistics vary considerably by major with only 5% of new engineers unemployed and 20% underemployed compared to students in Liberal Arts where 8% were unemployed and 52% underemployed.

Forward, Pay It Back program uses an IBR with no loan forgiveness and no interest as its model. The borrower pays a maintenance fee and continues to pay a fixed percentage of his income until the loan is paid off. With this instrument payment risk – the ability to meet the monthly payments required – is minimized but the number of years of repayment remains, in most cases, uncertain.

HCC/ISAs are structured differently. There is no loan, so there is no principal or interest assessed. Students pay a certain percentage of their incomes for a fixed number of years. For example, students who obtain a bachelor's degree under the proposed Oregon plan using an HCC would pay 4% of their annual income for 20 years. Students will ultimately pay more or less for their degree depending on the financial benefit they receive from the credential. There is no initial principal balance, no potential for a ballooning balance due to penalty and interest charges and little possibility that their monthly payment will outstrip their ability to pay.<sup>22</sup> While the total amount to be paid is uncertain – it varies with the student's income over the next twenty years – the payment risk is minimized. It will always be 4% for the life of the 20 year contract. Both types of Pay It Forward financing instruments minimize payment risk to the borrower and should result in lower levels of default which can make them appealing instruments for both financier and borrower.

While either an IDR/IBR or an HCC/ISA can be the financing mechanism for a Pay It Forward program, it may be that the HCC/ISA has some advantages over a loan. HCC/ISAs and some IDR/IBRs (those structured with loan forgiveness): (1) relieve the student's uncertainty about being able to make fixed loan payments; (2) virtually eliminate default caused by financial distress; (3) are means and needs blind; and (4) provide a subsidy to those who most need it during the repayment period.<sup>23</sup> In addition, students with HCC/ISAs never face the prospect of "ballooning" loans due to interest and penalty charges, and may be considered better credit risks by banks for car loans and mortgages. Another important consideration is that HCC/ISAs can be structured to be revenue neutral to the state. There is some cross subsidization of students who obtain relatively low paying jobs upon graduation by students who obtain relatively high paying positions. This cross subsidy can net to zero. IDR/IBRs with loan forgiveness will cost the state money since the most any student pays is what he owes so the student who receives loan forgiveness essentially receives a subsidy from the state that will have to be paid for.<sup>24</sup> A brief look at the history of human capital contracts illustrates the potential appeal of these programs. It is

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<sup>22</sup> Some countries, such as Australia, set a floor income below which no payment is required. None of the state proposals to date had this feature.

<sup>23</sup> Palacios, *Human Capital Contracts: "Equity Like" Instruments for Financing Higher Education*, page 4. His four points were directed at human capital contracts.

<sup>24</sup> "If you go with a pure ISA idea you need to determine...whether the winners (high income graduates) will cover the losses (those students whose income is similar to high school graduates.) Alternatively, you may decide to run a program like Australia, where each student's obligation is capped at the funded amount (adjusted for inflation), in which case you are really signing up the Illinois taxpayers to cover the shortfall. You should really let them know ahead of time." From a 10.29.2014 email to ISAC from Casey Jennings, 13th Avenue Funding.  
[www.13thavenuefunding.org](http://www.13thavenuefunding.org)

important to note that, despite the recent interest in these types of programs, none have been implemented by any state in the U.S. even in pilot form.

### *Overview of Human Capital Contracts*

The structure and mechanics of IDR/IBRs are fairly well known because the federal government has been offering several versions of IBRs in its Direct Loan Program. The concept of an HCC/ISA has been around for quite a while but implementation has been spotty. The idea of HCC/ISAs was initially proposed over 60 years ago by Milton Friedman and Gary Decker at the University of Chicago<sup>25</sup>. Friedman's idea had the federal government paying for school and collecting a portion of future earnings as a way to bring the control of the market to higher education. He liked the private signals for the value of education that would be evident with this approach since students would be offered less favorable contracts for high cost/low return fields. He wanted however, a public/private partnership because he believed that the federal government could administer the program most efficiently.

His ideas got little traction in the United States until the 1970's with what has come to be known as the Yale experiment (the Tuition Postponement Option). Students who selected the option were assigned to a cohort of students. Each cohort of students had to pay back a percentage of its earnings for 35 years or until the debt for the entire cohort was paid off. There were buyout provisions for those who felt they received a bad deal. Ultimately the buyout provisions were utilized by wealthy students and other students simply reneged on the deal. The program was closed in 2001 – before the scheduled closure. While most agree the program was not a success, the reasons suggested for failure vary. Opponents of the program claimed that inflation, tax law changes, and defaults put an ill-conceived program over the edge; proponents claim making the individual responsible for the behavior of the entire cohort and the expansion of the Stafford Loan program, preferred by students, finally killed it.

Today, the only human capital contracts operating in the U.S. are descendants of a program begun in 2001 called My-Rich-Uncle. The program was privately funded and offered human capital contracts and private loans to students attending selective schools in programs with high earning potential. Undercapitalization drove the company into bankruptcy by 2008 but new companies offering similar products have materialized over the past few years.<sup>26</sup>

The idea has had more success abroad where some countries have moved from an entirely government funded higher education system to a shared responsibility model with these instruments. Proponents of Pay It Forward models advance the idea that HCC/ISAs and IDR/IBRs are already successful student financing instruments in other countries. In fact, the countries often mentioned, Australia, New Zealand and the U.K., used IDRs<sup>27</sup>, and not HCC/ISAs, to move their

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<sup>25</sup> "The Role of Government in Education" by Milton Friedman in R.A. Solow (editor) *Economics and the Public Interest*. Rutgers University Press, 1955.

<sup>26</sup> See Appendix II for a time line of HCCs and a description of the programs being offered today.

<sup>27</sup> Called Income Contingent Loans (ICLs) in Australia.

higher education systems from totally government funded to more of a “shared responsibility” model, called the Higher Education Contribution Scheme (HECS), where the student assumes part of the cost. The Australian contracts are based on an income-driven repayment program of loans (principal and interest, with a time constraint) rather than a human capital contract, a percentage of income over a fixed period of time. Under the IDR type of arrangement, the risk shifting is less, and wealthy students (students who pursue high paying fields upon graduation) do not pay significantly more than they might with an HCC instrument.

Australia was the first country to implement an IDR-based student loan system, in 1989; and the UK introduced its system in 1998.<sup>28</sup> Both implemented mandatory IDRs to introduce cost-sharing in an environment where students were paying no tuition and many received additional funds to help cover incidental costs such as books, housing, and food. Moving to IDRs helped ease the transition for students in these countries adjusting to the new tuition and fees by deferring repayment until after the student graduated and was earning a certain amount of money. In contrast, the introduction of federal IBRs for Stafford Loans in the U.S. has had the primary goal of reducing the extremely high burden of loans that many students already carry upon graduation.

The motivation for the movement to a shared responsibility model in Australia was the perceived inequity of a system where everyone’s taxes were being used to support education for a relatively few students. That is, public money was being used to pay the costs of higher education in full, but only a small number of students were able to attend. The HECS expanded opportunities to attend college for more Australians by providing extra funding from the HECS. The mandatory IDRs in both Australia and the U.K. generated additional revenue for the universities to expand students’ slots and increase institutional quality. The program was considered successful in achieving these goals.<sup>29</sup> Increasing college diversity or addressing equity concerns was not a primary Australian goal in contrast to the United States’ and, specifically, Illinois’ goals of narrowing participation and completion gaps between lower and higher income students.

There are two other significant differences between the Australian/U.K. model and a state model. The Australian and the U.K. systems are country-wide in contrast to an Illinois system that could only be state-wide.<sup>30</sup> They use their federal systems to collect the payments and all citizens’ federal taxes are filed individually (there is no joint filing for married couples.) This makes the repayment process relatively simple and efficient. The other difference is that most British and

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<sup>28</sup> For the Australian system, see Chapman, Bruce and Jane Nicholls. 2013. *Higher Education Contribution Scheme (HECS)*. Crawford School Asia and the Pacific Policy Studies Research Paper No. 02/2013.

<http://ssrn.com/abstract=2307733>. Parliament of Australia. 2000. Higher Education Funding Policy. <http://bit.ly/MrZQPk>. For the U.K. system, see Higher Education Funding Council for England (HEFCE). “Recent history of higher education in England.” <http://www.hefce.ac.uk/about/intro/abouthighereducationinengland/historyofheinengland/>. Student Loans Company (U.K.). *Student Loan Repayment: Income Contingent Loans*. <http://bit.ly/LwfQPu>.

<sup>29</sup> Palacios, 2004. *Investing in Human Capital*, pages 131-133.

<sup>30</sup> If a mandatory IDR or a HCC were to become the norm in the US, the scale would be vastly different. Australia has 340 institutions and the UK 160 compared to the US’s 7,400. Maximum tuition is set centrally in Australia and UK.

Australian students attend public universities where the government has control over tuition and fees – the government actually sets the rates. The relationship between tuition increases and income increases is extremely important in determining the viability of a Pay It Forward model.<sup>31</sup>

### *Pay It Forward Programs Being Investigated by Other States*

In July 2013, Oregon became the first state to sign into law legislation directing the Higher Education Coordinating Commission (HECC) in the state to study and consider proposing a pilot HCC program (H.B. 3472). Since then, legislation has been introduced in at least 24 states.<sup>32</sup> The legislation varies considerably by state and no program, pilot or otherwise, has been implemented as of November 2014. The Oregon pilot program was developed by the Oregon HECC-designated workgroup and submitted for consideration to the HECC in September 2014. The HECC approved the plan with stipulations but found that other competing priorities, including increasing need-based grant aid for students from lower-income families to be a higher priority. The HECC did not recommend implementation of the pilot program with an estimated peak annual cost of \$20 million.<sup>33</sup>

State Pay It Forward programs necessarily differ from the programs operating in other countries and the small private investor PIFs that operate today. As already discussed, the countries most often mentioned as implementing Pay It Forward programs, Australia and the United Kingdom, employ a federally-backed, IDR/IBR loan as the mechanism for deferring payment. Their programs are offered to most students and were designed to move their public higher education systems from systems that were essentially free to the student to more cost-sharing models of higher education services.<sup>34</sup> Their IBRs cover not only tuition and fees but also some of the associated costs of attending college. In contrast, the privately funded programs in the US and other countries are very small, targeted programs using human capital contracts priced specifically to individual students' abilities, major, school and potential future marketability. Most of these contracts can be used by students at private institutions and some are available for graduate students.<sup>35</sup>

Both of these models differ substantially from the state proposals and state goals. Unlike Australia and the United Kingdom, states do not have the tracking and collection resources of a federal entity and none are moving away from a totally tax-payer-funded system to a shared

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<sup>31</sup> The “hiding” of the actual cost of college has made it easier for Australia to keep raising tuition. In 2012 alone, it tripled its tuition charges. Both the U.K. and Australia are also considering selling off their portfolios to banks to generate even more revenues for the government. *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges* by Lauren Asher, Diane Cheng and Jessica Thompson. The Institute for College Access & Success (TICAS), 2014. [www.ticas.org](http://www.ticas.org)

<sup>32</sup> OR, FL, OH, IN, PA, NY, ME, VT, MA, RI, NJ, MD, VA, SC, IA, OK, HA, CA, WA, CT, LA, MI, NM and IL.

<sup>33</sup> *Oregon's tuition-free 'Pay It Forward' college finance plan appears dead.* OregonLive.com, 8/20/2014.

<sup>34</sup> Similar arrangements have been adopted in New Zealand, United Kingdom, Thailand, and Israel. See Appendix II for more information.

<sup>35</sup> See Appendix II for more information.

responsibility model. Instead, states will have to administer the program with state-level tracking and collection resources and would like to use these programs, in part, to increase affordability in a higher education system that is becoming less and less affordable just when its services are needed most. The Australian and the U.K. systems were moving away from a 100% tax-payer funded system to a system of shared responsibility where the students are picking up roughly a quarter of the cost.<sup>36</sup> In contrast, undergraduate students at Illinois public universities are already paying most of the cost of their education – over 75%.<sup>37</sup> Allowing them to defer payment of tuition and fees therefore would leave Illinois institutions with substantial holes in their operating budgets. Furthermore, unlike the operators of private programs, states are not interested in “cherry picking” the students most likely to succeed at prestigious, often private, institutions for their programs but rather are looking to expand access and affordability for all lower and middle income students attending public institutions.

While there are variations in the state proposals and many of them are not fleshed out in any substantive way, the states that have begun to define a potential Pay It Forward proposal usually have the following elements:

- Some type of contract between the state and the participant creating a repayment obligation. Both HCC/ISAs (Oregon) and IDR/IBRs (Pennsylvania) are being proposed.
- Some limit on student participation. All proposals seen so far have determined participation in these programs to be voluntary. Students have the option to opt out of the program. In addition, some programs further limit participation to students based on income or grades. The pilot programs described, by definition restrictive, further limit participation to students from certain high schools, attending certain colleges, or through a lottery selection process.
- All proposals to date require state residency.
- With one exception (California), the programs cover tuition and fees only at public colleges and universities. Tuition and fees are usually about 40 percent of the total cost of attendance. Students might still require loans for the other 60 percent of expenses. California is suggesting piloting part of its program at a private institution and proposes to cover costs in addition to tuition and fees.
- All suggested programs are for undergraduate education only.
- Some proposals require degree completion and usually propose converting the HCC/ISA to regular student loans for non-completers. Some states require on-time completion.

While many states are considering Pay It Forward proposals, *it is important to note that no state has implemented a Pay It Forward plan, even as a pilot.* Oregon has a fully designed pilot program ready to go but recently tabled it, at least temporarily, for lack of funds. The programs require high levels of upfront funding and have been met with much resistance by members of the higher education community. Those concerns will be addressed later in the report.

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<sup>36</sup> Palacios, 2004. *Investing in Human Capital*, pages 131-133.

<sup>37</sup> See Appendix IV.a and IV.b for IBHE worksheets.

## **The Pennsylvania Proposal: Pay It Forward, Pay It Back Pennsylvania**

The Pennsylvania proposal, that ISAC was directed by HB 5323 to consider, has all of these elements mentioned above. The Pennsylvania Pay It Forward program, called Pay It Forward, Pay It Back Pennsylvania (PFPBP), is an interest-free IBR that would be limited to state residents and covers tuition and fees only at approved state two and four-year institutions. The program would be administered by ISAC's counterpart in that state, the Pennsylvania Higher Education Assistance Agency (PHEAA).

The program has a need-based component, unusual in these types of programs. Eligibility for PFPBP would be based on the school attended and on the student participant's household income. Eligible schools would be Pennsylvania community colleges, public universities, and institutions designated as "state-related by the Commonwealth." Students from families with incomes of up to 300% of the poverty level would be eligible to defer all of their tuition and fees. Those with family incomes between 300% and 450% would be eligible for a deferment of two-thirds of their tuition and fees. Students with family incomes 450% up to 600% of the poverty level (maximum \$138,300) would be eligible for deferment of a third of their tuition and fees. Priority would be given on the basis of need if funds are short – the program would not be an entitlement, but would be subject to appropriation and limited to revenue from its financing sources.

The suggested payment parameters includes the following: (1) repayments would begin within three years after graduation; (2) payment would be deferred for graduate school; (3) a student would repay 0.8% of his adjusted gross income (AGI) for each year of community college or 1.15% of his AGI for every year of four-year school, plus a default insurance premium until the debt is paid off; (4) debt would not be forgiven after a specified time period, only for death or disability; (5) if the participant stopped working, taxable income would be estimated at one-half of the former income (e.g. those who leave the workforce to care for children or parents); and, (6) participants who failed to pay would be subject to debt collection.

The bill proposes funding the program with a natural gas severance tax, interest earned on the fund, and payments into the fund from participants. The bill would also require a report on stability of the fund every three years.<sup>38</sup>

## **The Oregon Model: Pay It Forward, Pay It Back**

The Oregon Pay It Forward (PIF) model mentioned in the introduction, the most completely developed of the proposals, provides a contrast to the Pennsylvania model and provides some insight into the potential range of these types of programs (see Figure 3 for a side by side comparison). The Oregon model enumerates some "founding principals" including specific

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<sup>38</sup> Pennsylvania Senate Bill 1094: *The Pay it Forward, Pay it Back Pennsylvania Act – Reduction of Student Debt*, September 16, 2013.  
<http://www.legis.state.pa.us/cfdocs/billInfo/BillInfo.cfm?year=2013&ind=0&body=S&type=B&bn=1094>

instructions that PIF should not replace public contributions and the state must also expand its support for higher education in the future. Participation in the program is voluntary and is not need based and will cover the full cost of tuition and fees as long as students meet the pace requirements. The pilot program proposed is limited to students from certain high schools and a group chosen through a stratified random selection process.

Participants in the Oregon PIF program would sign an HCC/ISA that is based on credit hours attempted. Students would pay 0.0167% of annual income or 0.0222% of annual income per credit hour depending on whether those credits were earned at a community college or public university. For a two-year degree program finished with the minimum number of credit hours, this results in a contribution rate of 1.5% annual income by the community college graduate, and for a typical public university graduate who completes her program with the minimum number of credit hours, the percentage would be 4.0%. The contribution rates would be calculated per credit hour and students could determine how many credit hours each term they wished to “PIF.” Students could PIF credit hours in excess of the minimum needed to complete their programs but they could not PIF credits that would result in an annual contribution of over 5%. Students would have a six-month grace period after “completion of the terminal degree or cessation of studies” before they begin repayment. Students would make their contributions in the repayment period for 20 years, and there would be no “buyouts” or capped contribution limits over that period.

Oregon is proposing to implement a pilot program of 4,000 students, phased in over four years. Participants would largely be selected by a lottery but all qualified students from a few high schools primarily serving lower-income students would be eligible for the program. Bonds would be the funding source.<sup>39</sup>

Although the reasons for considering a Pay It Forward program are similar for the two states, with the issue of college affordability being the biggest problem that both states wish to address, the two Pay It Forward models, Pennsylvania’s and Oregon’s, have some striking differences and demonstrate the range of possibilities for these programs. In particular, they differ in the financing instrument for the participant, the eligibility requirements, the accounting methodologies, and how each state is going to pay for it all.

### **Differences Between the Oregon and Pennsylvania Pay It Forward Programs**

The Pennsylvania program uses a state sponsored IDR/IBR to defer payment until a student graduates; the Oregon proposal uses an HCC/ISA. As already discussed, HCC/ISAs are instruments for financing higher education that would allow students to attend college without making tuition

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<sup>39</sup> *House Bill 3472: Pay It Forward. A report to the Oregon higher Education Coordinating Commission from the Pay It Forward Workgroup.* 2014. <http://education.oregon.gov/Documents/HECC/Student%20Success/8-13-14/PIF%20Report%20Draft%208-7-14d.pdf>

# Oregon

# Pennsylvania

Figure 3

## *Pay It Forward, Pay It Back Proposal*

## *Pay It Forward, Pay It Back Pennsylvania Proposal*

### Primary, available proposal components:



Both proposals include a residency requirement and would cover tuition and fee costs only



Applicants would be chosen from a lottery and from pre-selected high schools from across the state



Total program participation could not exceed 10 years (for intermittent students) regardless of degree attainment



Would repay a percentage of future AGI contribution based on number of quarter credit hours a student participated:

- 0.75% per 45 credits at a community college
- 1% per 45 credits at a four-year institution
- Students will choose if they want credit hours to be included in their PIF payment plan or funded in some other manner



Payment would begin six months after completion of terminal degree (bachelor's if student goes on to graduate school) or the student ceases enrollment



Payments would last for 20 years in all cases (no buyouts or capped contribution limits)



If the Oregon Opportunity Initiative would have passed during the November elections, the Treasurer's office would have been allowed to issue bonds for non-capital requests. This could have been used, in whole or in part, to fund the PIF pilot. This bill did not, however, pass.



Pilot Schools include a community college, a university of the State System of Higher Education, Pennsylvania State University, University of Pittsburgh, Temple University, Lincoln University, and any other institution designated as State-related by the Commonwealth



Eligibility would be based on participant's household income as a percentage of the Federal Poverty Line (FPL)



Would repay the amount of any funds received for tuition and fees, plus a default insurance premium amount. Monthly payments would be:

- Eight-tenths of one percent of AGI for every year of community college attended
- One and fifteen-one-hundredths percent of AGI for every year of State university or State-related university attended



Payment would begin no later than 36 months after the participant graduates or becomes employed full time, whichever comes first



Monthly payments would continue until the participant has fully paid the amount due



The program fund would consist of:

- Funds received from the natural gas severance tax (established by this legislation);
  - Five percent on every unconventional gas well in the state
  - Payments made by participants;
  - Any interest earned on the fund; and
  - Any other funds appropriated or made available to the fund.

and fee payments up front. Students would sign a contract to pay a portion of their income for a specified period of time after graduation and entering the workforce. “HCCs [differ from IDRs because they] are financing mechanisms that require payments based on a percentage of the recipient’s income for a fixed period of time, but the amount originally financed is not technically a loan because there is no principal or interest to pay down.” Although it is billed as a “debt-free” degree, in reality it “simply defers the cost of tuition until the student is no longer in school and finances it with a future financial obligation that is called something other than a loan.”<sup>40</sup> HCC/ISA’s minimize risk to the student by basing payment on future earnings: if a student does well post-graduation, he pays more; if he has difficulty, he pays less. The risk of default is also reduced, as it is with an IDR/IBR, because default due to inability to pay is minimized.

HCC/ISAs can create a situation where those who do very well post-graduation can wind up paying far more for their education than those who don’t fare as well. The potential for inequity in payment disturbs some critics of HCC/ISAs. To reduce this impact, income subjected to a PIF can be capped. Capping “PIFable” income is problematic for some private HCC/ISAs where the potential for large returns makes the program attractive, but state programs may find this solution works well as long as some subsidy is permitted to occur.

Figure 4

ISA (Income Share Agreement)	IDR (Income Driven Repayment)
<ul style="list-style-type: none"> <li>▪ Future financial obligation expressed as a % of designated income over a fixed period of time.</li> <li>▪ Minimizes payment risk.</li> <li>▪ No principal amount that can accrue interest.</li> <li>▪ Amount paid will vary by income increases post graduation – financially successful students will subsidize less successful students.</li> <li>▪ Program can be self-sustaining, the cross subsidization can net out and program may not require long-term subsidization.</li> </ul>	<ul style="list-style-type: none"> <li>▪ A loan with principal and usually interest, with payments set by a percentage of income. It can have a fixed payment period and loan forgiveness or be variable in length with no loan forgiveness.</li> <li>▪ Minimizes payment risk.</li> <li>▪ Principal balance and interest amount owed that can generally “balloon”.</li> <li>▪ Students in low-paying fields paying on interest-bearing loans with no loan forgiveness will pay more for their educations.</li> <li>▪ If loan forgiveness is present the program always runs at a deficit and requires subsidization.</li> </ul>

<sup>40</sup> *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges* by Lauren Asher, Diane Cheng and Jessica Thompson. The Institute for College Access & Success (TICAS), 2014. [www.ticas.org](http://www.ticas.org)

IDR/IBR loans also can take different forms. Currently the federal government offers several options for students with Stafford Direct and Federal Family Education Loan Program loans.<sup>41</sup> One of the features with the federal IDRs is loan forgiveness after a specified number of years – usually 20 or 25 – for borrowers with income levels low enough to qualify for that option. The Australian HECS is driven by interest-free IDR loans without loan forgiveness options. The state-sponsored IDR proposed by Pennsylvania is also interest-free but charges a “default insurance premium” and has no loan forgiveness except for death or disability. The cumulative amounts initially borrowed under the Pennsylvania Pay It Forward plan could be higher than most federal IDRs depending on other financial aid provided. Federal IDRs are based on loans that conform to the Stafford maximums - \$31,000 maximum for a dependent student.<sup>42</sup> A dependent student who qualifies for a full Pennsylvania IDR at Pennsylvania State with annual tuition and fees of about \$16,000 could wind up borrowing \$64,000 under a four-year state IDR loan.

An IDR minimizes payment risk to the student – he is not asked to pay more than a certain percentage of his income. However, interest charging IDRs with no loan forgiveness do not minimize the cumulative debt size risk. The interest on the loan still accumulates and if the borrower’s income level falls, his payment falls but the repayment period extends to fully pay off the debt – with additional interest. Without loan forgiveness after a number of years of repayment, borrowers who are in lower-wage occupations, who are already receiving a lower financial return on their education investment, can wind up paying much more for their education than borrowers who enter high income fields. By not charging interest, Pennsylvania seems to have sidestepped this problem to some degree but the details of the default insurance premium were not provided. If the default insurance premium is treated as an annual charge, then some accumulating debt is possible in the Pennsylvania plan. This would result in lower-income graduates, who take longer to repay, ultimately paying more than their higher-income classmates.

The Oregon and Pennsylvania plans also differ in eligibility requirements and accounting methodologies. Both plans require state residency and attendance at a public university or community college. But Oregon puts no other restrictions in place while Pennsylvania allows only very low income students to PIF all their costs. The Pennsylvania program tracks PIF commitments annually based on full-time attendance. The Oregon model, which appears to be more flexible and is used in the examples created for this report, tracks PIF percentages by credit hour. This methodology accommodates students who attend part-time, change schools or drop out. The PIF percentages are simply added together for a customized PIF for each student based on his attendance pattern. It also allows students to PIF any percentage of credit hours attempted each term. For example, a student could sign up for fifteen hours, pay the tuition for five upfront and PIF the remaining ten hours.

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<sup>41</sup> See Appendix VIII.a. for IDR loan options in the US.

<sup>42</sup> A dependent student is a “traditional” student, a student under 24 years of age, unmarried, without dependent children, and not in the military.

## Interest in Pay It Forward at the Federal Level

Two federal bills have been introduced to make it easier for both private entities and states to develop Pay It Forward models. These bills could change the perception of human capital contracts and encourage states to develop them. At a minimum, passing these bills would clarify the legitimacy of this type of financial instrument and provide some guidelines for implementing programs utilizing them.

Federal bills H.R. 3959 and S. 1884, The “Pay It Forward” Guaranteed College Affordability Act, are sponsored



### Federal Legislation

#### Pay It Forward College Affordability Act of 2013

(H.R. 3959 and S. 1884)

U.S. Senator Jeff Merkley and U.S. Representatives Suzanne Bonamici and Dan Kildee

*Would direct leaders at the U.S. Department of Education, U.S. Department of the Treasury, and the Consumer Financial Protection Bureau to conduct a study on the feasibility of, and options for, implementing a Pay It Forward model, "in a manner that is in the best interests of students." Not later than a year after the completion of such initial study, a limited number of states may apply for competitive grants to carry out a Pay It Forward pilot program in their state. Unlike the majority of state legislation introduced, the federal legislation includes a state contribution and maintenance of effort requirement.*

\* Both bills have been referred to committee.



### Federal Legislation

#### Investing in Student Success Act

(H.R. 4436 and S. 2230)

U.S. Senator Marco Rubio and U.S. Representative Tom Petri

*Introduced to help create the legal framework for Income Share Agreements (ISAs). The framework is very similar to Oregon's Pay It Forward except the legislation allows private lenders to provide income share agreements. The legislation provides some basic restrictions on ISAs to protect consumers (15% Cap, 30 year limit) and also clearly focuses on the potential problem areas (definition of income, income tax treatment, disclosure requirements). It also reduces some of the legal uncertainty for parties that are trying to create ISAs by recognizing the agreements through federal law.*

\* Both bills have been referred to committee.

by members of the Oregon Congressional delegation. The legislation directs the Department of Education, the Department of Treasury and the Consumer Financial Protection Bureau to conduct a feasibility study and provide options for implementing a Pay It Forward program “in a manner that is in the best interest of students.” A year after the study is completed, a limited number of states may apply for competitive grants to carry out a Pay It Forward pilot program in their state. Unlike the majority of state legislation currently introduced, this federal legislation includes a state contribution and maintenance of effort requirement.<sup>43</sup>

Federal bill H.R. 4436 and S. 2230, entitled the “Investing in Student Success Act of 2014”, appears to “provide the legal framework necessary for the growth of innovative private financing

<sup>43</sup> H.R.3959, the Pay It Forward College Affordability Act of 2014, was introduced in the House on January 29, 2014 and referred to the House Education Committee. It was then referred to the Subcommittee on Higher Education and Workforce Training on June 13, 2014. S1884, the Pay It Forward College Affordability Act of 2013, was introduced in the Senate on December 20, 2013 and referred to the Senate HELP Committee.

options for students fund postsecondary education...” The bill authorizes “individuals to enter into income share agreements for the purposes of obtaining funds in exchange for agreeing to pay to the holder of the contract a specified percentage of the individuals’ future income.” It requires that terms and conditions of income share agreement contracts be explicitly specified including the percentage of future income encumbered; the definition of income that would be devoted to contract repayment; the maximum time period for repayment, and any early termination conditions. The bill further requires that the person issuing the contract provides a disclosure document. The bill also outlines the federal tax treatment for program participants and contract holders and indicates the treatment of PIFs for the purposes of calculating eligibility for federal financial aid.<sup>44</sup>

## **The Controversy Over Pay It Forward Programs**

While state legislatures have found much to like with at least the concept of state Pay It Forward plans, higher education professionals and advocates are almost unanimous in their disapproval of these plans and have issued a number of position papers denouncing the idea.<sup>45</sup> Those that promote Pay It Forward programs tend to want the market to help shape the choice of occupation for students, are concerned about up-front college costs being a barrier to college entry, and see Pay It Forward programs as a way to minimize the risks associated with taking on large amounts of debt. Those who do not support Pay It Forward programs are also worried about up-front costs being a barrier to college entry and the large debt levels that students are acquiring relative to their starting salaries. However, they feel that Pay It Forward programs do not satisfactorily address these concerns, and they have other reservations that can be categorized as: philosophical issues with the concept of Pay It Forward and the consumer and community signals it sends, funding issues, implementation issues, and collection issues.

### ***Positive Attributes of Pay It Forward Programs***

For those who endorse them, Pay It Forward plans appear to address the financial issues students, schools and the state face today, specifically annual college costs that now far exceed the average family’s ability to pay and the prospect of cumulative debt levels exceeding the student’s annual income upon graduation. Proponents believe that well-designed Pay It Forward plans, with either a human capital contract or an income-driven repayment program as the engine, could:

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<sup>44</sup> Investing in Student Success Act – House bill number H.R. 4436 and Senate bill number S. 2230 (identical bills). They were introduced in April and the House bill was referred to a House Education Subcommittee in June. The Senate bill is with the Finance Committee. There has been no movement on either bill. See Appendix V for more detail on these bills.

<sup>45</sup> American Association of State Colleges and Universities (AASCU), American Association of University Professors (AAUP), AFL-CIO, American Federation of Teachers (AFT), Colorado Student Power Alliance, Education Trust, Jobs With Justice, National Education Association (NEA), Student Labor Action Project (and University of Oregon Student Labor Action Project), and The Institute for College Access and Success (TICAS) have all come out against PIFs.

- Eliminate the up-front, direct costs of higher education. Students might pay more or less than under a conventional loan system, but the amount could be bounded and uncertainty would be reduced. Although most state PIF programs that have been proposed only deferred tuition and fees, other models where other costs are also deferred, such as the Australian model, have been used successfully for many years.
- Shift the risks associated with rising college costs and uncertain student post-college employment to those who can bear them. If a borrower earns more in the future he pays more; if he earns less, he pays less. Payment risk, the risk that the payment requirement would exceed a borrower's ability to pay would be minimized for the borrower under either an HCC/ISA or an IBR/IDR. Size of debt risk, debt that does not decrease after years of repayment due to late or missed payments, or insufficient payments causing additional fees and interest to be charged, would also be minimized under both options. IDR/IBR's usually have a maximum number of years of repayment (although Pennsylvania's proposal does not) and an HCC/ISA is, by definition, a percentage of income for a fixed number of years. These risks would be shifted to the lender or investor. With private contracts the investor bears a risk proportionate to his return; with state programs the state/taxpayers would bear the risk; a federal program would have the country/taxpayers assuming the risk.
- By reducing the impact of the family budget constraint, HCCs could eliminate a major barrier to college attendance and completion. Family income would matter less; students could base their school and professional choices on other, more meaningful attributes. These programs could reduce the restriction on career choices due to the fear of overwhelming debt. PIFs could also provide information on returns to college. Private PIF programs can highlight high and low performing colleges and majors in terms of financial returns on investment. It may be possible to structure a state program to do the same.<sup>46</sup>
- A Pay It Forward Program could keep within the state both Illinois students and education funds currently leaving Illinois. Programs providing "free" or reduced-priced college have had mixed results in states and communities where they have been tried when the goal has been to keep exceptional students or students from wealthy families in state but overall there is some indication that these programs do keep good students and middle-class students in state.<sup>47</sup> A PIF program also would keep in Illinois the share of student income

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<sup>46</sup> For example, Australia now has levels in its HECS. The Higher Education Contribution Scheme (HECS) became policy in 1989, requiring all Australian undergraduates to pay a uniform charge, with the timing and level of payment dependent on income. Under the original HECS, an \$1,800 fee was charged to all university students, and the Commonwealth paid the balance. In 2005 a HECS debt became known as HECS-HELP, maintaining the same principles of HECS. The Government administers the Higher Education Loan Program (HELP) which consists of five HELP loan schemes to assist students with the cost of their fees. The right loan depends on the student's circumstances, eligibility and where she wants to study.

<sup>47</sup> For example, the Kalamazoo Promise has helped keep the middle class in Kalamazoo – which was one of its primary goals. "The suburban flight stopped after the Promise was made. The city's population has held steady,

now devoted to paying federal interest on student loans. Even if a student chooses to leave the state for work, her PIF dollars would still be collected by the state and be returned to the trust fund.

- An additional benefit for the student may result with Pay It Forward programs driven by a human capital contract. Students with an HCC/ISA could appear to be more credit worthy as the HCC/ISA does not show up as a debt obligation, as does an IDR/IBR, with its potential for “ballooning” through additional interest, penalties and other charges. While the obligation can be considered as a lien on future income, that fraction of future income is bounded by the PIF. Pay It Forward programs that are financed with an HCC/ISA may refute the argument that PIF programs are essentially redundant because existing federal IBR loan programs already address the payment issues that can influence career choice and result in long-term high loan debt levels.
- State sponsored PIFs may also be seen as more reliable than federal IBRs. Although states have been known to alter their program, sometimes on short notice, federal IBRs have been changed repeatedly by Congress in the past and there is no guarantee that existing programs such as the federal Pay As You Earn (PAYE) program will remain in effect each time Congress or the Administration changes. Also, state PIFs can cover the full cost of tuition and fees. Stafford loans for dependent students are capped at \$27,000 for four years and have a lifetime cap of \$31,000. These amounts will not cover the costs incurred by students in Illinois for tuition and fees alone at public universities. The gap is often filled with high priced private loans and federal PLUS loans at relatively high interest rates.

### ***Potential Problems with Pay It Forward Programs***

Those opposed to Pay It Forward programs make their arguments several ways: (1) they are not feasible (difficult to administer and especially hard to collect the payments); (2) they will not have the impact on affordability as advertised; and (3) they will encourage the state and the schools to resort to behavior not in the best interest of students. The last issue is the biggest. Pay It Forward programs mean for many critics the implicit shifting of the notion that higher education is a public and a private good to being strictly a private good conferring no benefits worth paying for by the state. Impacts from this shift from public to private support include increasing the cost of higher education to the student. This increased cost and perception of unaffordability would be further enhanced if need-based grants were defunded to pay for the program. Converting need-based grants to income share agreements which will be perceived by lower income students, who are loan-averse, to be loans, is likely to lower participation rates among the student groups who have long been shut out of higher education.

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and the demographic mix in the school system has stabilized.” *Why these Kids Get a Free Ride to College*, by Ted C. Fishman, September 13, 2012, New York Times Magazine.

## Shifting the Costs of Higher Education from the State to the Student

No problem is mentioned more in the literature critical of Pay It Forward programs than the potential for cost shifting. While many different types of cost shifting can occur with the implementation of a Pay It Forward plan and some types may be considered to be beneficial, the real fear is that Pay It Forward programs will further focus attention on the private benefits to education instead of the societal, and will accelerate the shift that many believe is already occurring, away from a publically funded model of higher education to a student and family funded model by eliminating taxpayer subsidies to public higher education. Under a Pay It Forward Plan, it would be easier to hide the further erosion of the shared responsibility funding system that all states have now to some degree.<sup>48</sup> It could also exacerbate schools' tendency to increase tuition and fees at rates far in excess of inflation, a particular problem in Illinois. Illinois has some of the highest public university tuition and fees in the country.<sup>49</sup> A Pay It Forward program could provide cover for further increases. One analyst sums up the problem:

We have lost sight of two critical things. First, there is a broad societal function of education: ensuring that our democracy has informed voters capable of full participation. A focus on that function means funding public postsecondary education through taxation, shared progressively across all citizens of a state. Furthermore, it means constraining those public institutions from developing elaborate university activities [that] while enjoyable for participants, [is] putting college beyond financial reach for the general public. A focus on high-quality postsecondary learning with few extras, no frills, could be provided and publicly supported with a true social compact, one involving all key partners, including the federal government. Turning the energy around this proposal into a constructive plan that moves toward that goal would be a smart move.<sup>50</sup>

That there has been a trend in public higher education to reduce the contribution by the state and increase the contribution made by students and their families is beyond dispute.<sup>51</sup> While it is more likely an economic expediency due to tough budget situations than a philosophical belief that the benefits of higher education accrue only to the student and provide no additional benefit to the state, critics are worried that a Pay It Forward model, after an initial state investment, would

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<sup>48</sup> See, for example, *Don't Pay It Forward* by Kati Haycock from the Education Trust, Inside Higher Ed, November 4, 2013; *"Pay It Forward" or "Pay It Yourself?"* by Sara Goldrick-Rab. The Century Foundation Issue Brief, July 23, 2013; *The "Pay It Forward" College Financing Concept: A Pathway to the Privatization of Public Higher Education* by Thomas L. Harnisch. American Association of State Colleges and Universities, July 2014. Policy Matters: A Higher Education Policy Brief. Links to articles listed in bibliography.

<sup>49</sup> College Board, *Trends in College Pricing, 2013*, page 17.

<sup>50</sup> *"Pay It Forward" or "Pay It Yourself?"* by Sara Goldrick-Rab. The Century Foundation Issue Brief, July 23, 2013. <http://www.tcf.org/work/education/detail/pay-it-forward-or-pay-it-yourself/>

<sup>51</sup> Nationwide, 25 years ago, tuition and fees comprised 26.6% of public postsecondary school revenues; today it is 50.7%, a 24.1% change. In Illinois, the change has been lower but still significant, rising from 21.3% to 36.7%, an increase of 15.4%. Source: SHEEO's Net Tuition as a Percent of Public Higher Education Total Educational Revenue, 1988-2013, 2014. see Appendix VII.h. for additional data.

mask the shift and make raiding higher education dollars easier to do.<sup>52</sup> As one report concludes: “...revenues from HCC payments would be relied on to comprise a significant portion of the funding base for public higher education going forward, accelerating the shift from public higher education being financed by a combination of taxpayers across the generations, students, and students’ families to being primarily financed by students themselves.”<sup>53</sup>

While some entities favor Pay It Forward programs because they do have the potential to decrease state funding of higher education, the motivation for most of the proposed state legislation appears to be to improve access and affordability for students from both lower and middle income families and retain these students in state.<sup>54</sup> Many of these initial legislative proposals, however, call only for studies and offer few specifics. None of them, to date, attempt to address these important concerns – declining responsibility on the part of the state and little cost control on the part of the schools – that most critics mention in their objections to the program. Oregon, which has provided the most detail through a report provided to the Oregon Higher Education Coordinating Commission, explicitly states that one of the Pay It Forward ten “Founding Principles” is that “PIF should not replace public contributions; the state must also expand financial support of public higher education in the future.”<sup>55</sup> But no plan has suggested a method to ensure that these goals are carried out.

### Other Kinds of Cost Shifting

Two other types of cost shifting are often mentioned when discussing the impacts of Pay It Forward programs and they appear to be somewhat contradictory. Because students may wind up paying very different amounts for education at the same school, the first claim is that wealthy students explicitly subsidize poorer students, a situation that critics view as inherently unstable, often citing the “failed” Yale experiment as justification.<sup>56</sup> The second type of cost shifting

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<sup>52</sup> Australia has already demonstrated that Pay It Forward programs make it relatively easier to charge tuition and fees without a public outcry or a reduction in participation. “...a major consequence of the substantial revenue received from HECS is that the government increased the number of places available ... the data show a very large increase in the total number of domestic students since the introduction of HECS in 1989. *The Australian University Student Financing System: The Rationale for and Experience with Income-Contingent Loans* by Bruce Chapman, in *Financing Higher Education and Economic Development in East Asia* edited by Shiro Armstrong and Bruce Chapman, 2011.

<http://press.anu.edu.au/apps/bookworm/view/Financing+Higher+Education+and+Economic+Development+in+East+Asia/7301/Text/ch05.html>

<sup>53</sup> *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges* by Lauren Asher, Diane Cheng and Jessica Thompson. The Institute for College Access & Success (TICAS), 2014. [www.ticas.org](http://www.ticas.org)

<sup>54</sup> For example, Pennsylvania’s proposed program is need-based; New Jersey is investigating PIFs as part of its College Affordability Study Commission responsibilities; Michigan’s pilot program would be known as the Smarter Michigan and Retaining Talent (SMART) Tuition Program;

<sup>55</sup> *House Bill 3472: Pay It Forward. 2014. A report to the Oregon Higher Education Coordinating Commission* from the Pay It Forward Workgroup. See Appendix V.

<sup>56</sup> There are different interpretations about what happened at Yale. The program was not analogous to state programs now under consideration. It was an income-contingent loan with a 35 year repayment plan. It made each student in a particular student cohort responsible for all the debt in the cohort. No student paid off his debt until the entire cohort’s debt was retired. There was a 150% of the initial obligation cap – which could also be used

mentioned is from the state to the lower income student. Critics of Pay It Forward claim that students from lower income families may pay more as grant aid is eliminated. Some of the proposed programs target an existing need-based grant as an initial source of funding and it is feared that more would do so if these programs were adopted.

Currently, students coming from families who are reasonably well off often pay the least for their education, largely because they do not have to finance much of it through loans. They also often receive merit aid despite having no financial hardship because they attend good high schools and score relatively highly on standardized college admissions tests. Poorer students, even with need-based aid, must finance much of their education through student loans. This raises the cost of their education, in some cases exceeding the cost of college for students from wealthier families. Average to good students from middle-income families today often fare the worst. The families are too “rich” to qualify for need-based aid and their students often don’t have the high test scores that are necessary to capture a share of the limited institutional merit aid. Making matters worse, students often can’t borrow enough through the Stafford program to cover all costs, driving parents to Federal PLUS Loans that have no interest subsidy and are currently at 7.21%. Students from middle income families often have to borrow more and at higher rates than students from lower income families.<sup>57</sup> Obviously, the current situation is not ideal and a minimum constraint on any type of Pay It Forward plan would be that it should be an improvement on the status quo.

A second type of cost shifting that could occur is among “wealthy” and “poor” borrowers. There is a fear of program instability if the wealthy students are required to pay more for their education than others. In this case, wealth comes not from parents’ income but a financially successful career after college. HCC/ISAs, by definition, are designed to extract more money from financially successful participants than students who choose less lucrative professions. The fear of program instability is largely based on the Yale experiment where wealthy students either bought out their obligations or refused to pay on the basis of “unfairness.” Much of the blame for unfairness can be attributed to the model design where students who had no control over each other’s behavior were essentially made responsible for their debts. No debt obligation for any student was discharged until the entire cohort’s debt was paid off, a singular situation and one not likely to be repeated.

There are two responses to the claim of detrimental cost-shifting. First, the existing cost shifting favors those who can most afford the costs of college by saddling those who cannot with long-term, relatively high interest debt. The cost shifting that occurs with a Pay It Forward Program, takes more from students who benefited the most from their education and who are reaping higher returns to their investment. This could be considered an improvement over the current situation where poor and middle class students, who often enter the workforce in

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as a “buy-out”. Given these fundamental differences, there is still some question about what caused the program to terminate early. Some say it was poor design resulting in wealthy students wanting out and defaulters refusing to pay (and not being compelled to pay) that put a very great burden on the rest of the cohort. Others believe it was the advent of the Stafford student loan, which was preferred by students, that ultimately killed the program.

<sup>57</sup> The baseline dollars and percentages for Illinois students by income quintile are found in Appendix VII.a. of this report.

necessary but not particularly lucrative professions such as teaching and nursing, now pay more for their education than wealthy students. As will be demonstrated in the specific Pay It Forward program analysis, because of the high debt levels and interest rates, students from lower income families, even with financial aid, can wind up paying more than a student with parents who can afford the cost. Charging students who benefit more from education more to acquire it would appear to be preferable to the reverse.

The second response to the claim of unfair cost shifting is that the redistributive effect of a Pay It Forward program can be capped. Several private human capital contracts have an income cap in the agreement - in two of them it is \$200,000 - no income over \$200,000 is subject to the percentage.<sup>58</sup>

### College Cost Increases

College cost increases are a related issue. Reduced state funding is responsible for some of the cost increases in higher education but not all of it, especially in Illinois. Of the nearly \$1.2 billion real dollar increase in university income funds (made up primarily of tuition and fee revenues), only about half can be attributed to decreases in state funding. The other half is due to system costs that have risen in *excess* of inflation.<sup>59</sup> It is feared that lack of transparency could make increasing tuition and fees easier and those opposed to Pay It Forward programs cite the Australian example of large price increases with relatively little student protest as an example. These increases are occurring despite Australia and the United Kingdom both having largely public education systems with tuition and fee charges controlled by the government. In Illinois, where there is virtually no state control of public university tuition and fees, the potential for cost increases could be even greater.<sup>60</sup>

Another possible impact mentioned in critiques of these programs is that it could tie institutional budgets to post-graduate incomes and program contract terms and thereby affect the types of programs that universities offer, with the goal being to maximize graduates' earnings to increase university revenues. The fear is that, depending on how the revenues from student contributions paid under Pay It Forward are distributed, relatively low paying jobs with important societal impacts such as teaching, social work and health care could be undersupplied when the criteria for success is future earnings. College could become even more expensive and less responsive to societal needs as institutions try to maximize the return from their students. A likely

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<sup>58</sup> See Appendix II. One program with a \$200,000 cap is offered by Education Equity, Inc. that is based in Chicago and provides income share agreements to teachers who are pursuing graduate degrees.

<sup>59</sup> *Setting a Context for Fiscal Year 2015 Budget Development*, IBHE Agenda Item, October 1, 2013. Exhibits 3 and 4. Community colleges are funded with state funds, property taxes and tuition and fees.

<sup>60</sup> How the higher education system works in different states/nations affects the impact of the HCC program. Key differences include: how college tuition is set, the higher education system's diversity and centralization, student loan interest rate policies, and the social safety net. *Should All Student Loan Payments be Income-Driven? Trade-Offs and Challenges* by Lauren Asher, Diane Cheng and Jessica Thompson. The Institute for College Access & Success (TICAS), 2014. [www.ticas.org](http://www.ticas.org)

distribution methodology would be based on the undergraduate cost of instruction, which is currently reflected in differential tuition and fees at Illinois public universities. Under that scenario, schools with high costs relative to other schools that do not produce graduates that obtain greater financial benefits than other students, would be at a disadvantage. It would be a clear market signal that other institutions were more efficient and provided students with better outcomes (smaller PIFs.)

College costs must stabilize for a Pay It Forward program to work and ultimately become self-supporting as discussed more fully later in this report. In no case can college costs rise above the increase in starting salaries for the participants in the program. Leaving price increases to the individual schools and instituting a Pay It Forward program would put the program in financial jeopardy immediately. In order for a Pay It Forward program to be successful, there must be some state oversight of public institution tuition and fees.

### **Reduced State Grant Aid for Lower-Income Students**

Some critics assume that one way the huge upfront costs of a Pay It Forward program will be paid is by eliminating grant aid and there is some evidence that this could happen. The Washington proposal called for converting pre-existing state grants for lower income students to HCC contracts.<sup>61</sup> Full implementation of these types of programs can cost \$1 billion or more in large states. In Illinois, about \$2 billion would be necessary to implement Pay It Forward for all students at both public universities and community colleges. Need-based grant programs, such as Illinois' Monetary Award Program (MAP) at \$370 million, are large programs that could seem like a tempting way to fill in the gap.

To ensure that participation rates for students from lower income families do not decline under a Pay It Forward program, existing levels of grant aid must be maintained. Lower-income families, particularly Hispanic families, have been shown to be averse to taking on loan debt.<sup>62</sup> There are many studies that demonstrate that increasing need-based grant aid has been shown to be much better at increasing college participation rates among at-risk groups than loans:

“The best way to support access, success, and affordability for low-income students is to reduce the price of college, either directly or indirectly through grant aid. ... The U.K. and Australia did not implement their universal IDR systems with access or success as the goal and there were no resulting increases in low income enrollment. In contrast, studies have found that grants are more effective than loans in increasing enrollment and completion, and that need-based grant aid in particular

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<sup>61</sup> Washington State Legislature House Bill 2619  
<http://apps.leg.wa.gov/billinfo/summary.aspx?bill=2619&year=2013>.

<sup>62</sup> *Student Aversion to Borrowing: Who Borrows and Who Doesn't*, a report by the Institute for Higher Education Policy and Excelencia in Education by Alisa F. Cunningham and Deborah A. Santiago. December 2008. “Asian and Hispanic students were less likely to borrow, even if they had substantial unmet need. The lower likelihood of borrowing held true across all types of institutions, income quartiles, and categories of attendance, including full time, part time, and mixed enrollment.”

increases college enrollment among low- and moderate-income students and reduces their likelihood of dropping out.”<sup>63</sup>

Given the overwhelming evidence that grants are more successful than loans when attempting to increase college attendance for at-risk groups, another parameter of a successful Pay It Forward program would be that existing grant aid, at a minimum, not decrease. *If grant aid was maintained*, Pay It Forward programs could reduce the cost of college for lower income students who chose to go into relatively lower-paying, necessary occupations such as teaching and nursing.

## Legal, Political and Investment Risks

Miguel Palacios, a professor at Vanderbilt University who has been studying financing human capital for over a decade and who founded Lumni, a company that manages human capital funds in Columbia and other countries, has identified four types of risks associated with private human capital contracts. These risks would appear to extend to state-sponsored HCC/ISAs used in Pay It Forward programs: legal uncertainty (risk of being unable to enforce an HCC/ISA), public risk (risk from policy changes), investment risk (uncertainty of student behavior and employment after graduation), and default risk (students do not comply with conditions of the contract).<sup>64</sup> Legal and policy risk must be mitigated before HCC/ISAs can develop; investment risk and default risk can be minimized by correctly structuring the HCC/ISA.

One factor that has inhibited the development of private HCCs in the United States is the uncertainty that they are legally enforceable documents. A decade ago, potential investors expressed doubts that HCC contracts would generally be enforceable in many states and whether

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<sup>63</sup> Li, Dai. 2008. “Degree Attainment of Undergraduate Student Borrowers in Four-Year Institutions: A Multilevel Analysis.” *Journal of Student Financial Aid*. Vol. 37, No. 3. <http://bit.ly/14HbrxP>. See also: Moore, Robert L., A.H. Studenmund, and Thomas Slobko. 1991. “The Effect of the Financial Aid Package on the Choice of a Selective College.” *Economics of Education Review*. Vol. 10, No. 4. Castleman, Benjamin and Bridget Terry Long. 2013. *Looking Beyond Enrollment: The Causal Effect of Need-Based Grants on College Access, Persistence, and Graduation*. National Bureau of Economic Research Working Paper 19306. <http://www.nber.org/papers/w19306.pdf>. Goldrick-Rab, Sara, Douglas N. Harris, Robert Kelchen, and James Benson. 2012. *Need-Based Financial Aid and College Persistence: Experimental Evidence from Wisconsin*. <http://bit.ly/12iY97R>. Bettinger, Eric. 2010. *Need-Based Aid and Student Outcomes: The Effect of the Ohio College Opportunity Grant*. <http://www.sesp.northwestern.edu/docs/need-based-aid-why.pdf>. Chen, Rong and Stephen L. DesJardins. 2008. “Exploring the Effects of Financial Aid on the Gap in Student Dropout Risks by Income Level.” *Research in Higher Education* 49 (1): 1-18. Bettinger, Eric. 2004. *How Financial Aid Affects Persistence*. National Bureau of Economic Research Working Paper 10242. Heller, Donald. 2003. *Informing Public Policy: Financial Aid and Student Persistence*. WICHE. <http://www.wiche.edu/info/publications/InformingPublicPolicy.pdf>. Kane, Thomas J.. 2003. *A Quasi-Experimental Estimate of the Impact of Financial Aid on College-Going*. National Bureau of Economic Research Working Paper 9703. Sefor, Neil S. and Sarah E. Turner. 2002. “Back to School: Federal Student Aid Policy and Adult College Enrollment.” *The Journal of Human Resources* 37 (2): 336-352. Heller, Donald E.. 1997. “Student Price Response in Higher Education: An Update to Leslie and Brinkman.” *The Journal of Higher Education* 68 (6): 624-659.

<sup>64</sup> Discussion on contract enforceability and taxation is a summary of Miguel Palacios’ arguments found in *Investing in Human Capital*, Cambridge Press, 2004, pages 113 to 121.

they would be enforceable anywhere if the student declares bankruptcy.<sup>65</sup> A related but separate issue is the state and federal tax treatment of the student payments – how the payments made by students are treated for tax purposes.

According to Palacios, a human capital contract is enforceable “if the investor can legally demand from the student the percentage of income that the student agreed to pay.” If there are exceptions, then the investment will lose appeal. For example, in Columbia, the question arose regarding whether the contract would be ruled invalid on the grounds of the “universal right to education” Columbians believe every individual has. In Chile, there might be an enforcement issue if the “payments ...were disproportionately higher than the amount provided by the investor.”<sup>66</sup>

Federal bill H.R. 4436, “Investing in Student Success Act of 2014,” already discussed in this report, would clarify the federal government’s position on many of these issues. The bill specifically authorizes income share agreements, outlines the terms and conditions that must be specified therein, and provides guidance on the federal tax treatment for both program participants and contract holders.<sup>67</sup> The bill has not yet passed out of committee in either the House or the Senate and some modifications to the bill are expected.<sup>68</sup> It is uncertain when, or if, a federal bill related to PIF programs will be passed.

Tax treatments are also very important. The tax issues may be different for private PIFs and state PIFs. It is possible that if a student receives \$40,000 during the course of her education through a PIF, that it could be considered as income received and could be taxable. Assume upon graduation, she is employed at a job paying \$50,000 per year and is required, under the terms of the agreement, to pay 10% or \$2,500 per year for 20 years. Since that \$2,500 now belongs to the investor or the state, it is not the repayer’s money and should not be taxed if the PIF was taxed initially. If she remains in the state with the Pay It Forward program, it is likely that a state-level resolution of the issue would be sufficient for state taxation. It is very important that clarification of the federal tax treatment be made for a state PIF program to move forward. H.R. 4436, if passed, would help clarify the treatment at the federal level. But for students who leave the state upon graduation, the tax treatment in the new state is also not clear. Pay It Forward proposals could result in some double taxation issues that would make the program less appealing to potential participants. If PIF payments are treated as state grant dollars, and are not taxed, this is then not an issue.

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<sup>65</sup> According to one company CEO that was looking to make these investments, “there were two legal modifications required to make these contracts enforceable... because certain states prohibit the assignment of future income, residents of those states could challenge the validity of the contract in state courts. Given that students commit part of their future income when they engage in a HCC, it is not certain what the court rulings would be ...[creating] significant legal uncertainty.” HCCs require the same protection from bankruptcy laws that traditional student loan lenders enjoy. “*Human Capital Contracts: “Equity-like” Instruments for Financing Higher Education*”, by Miguel Palacios. *Policy Analysis*, No. 462, December 16, 2002, page 8.

<sup>66</sup> *Investing in Human Capital*, by Miguel Palacios, Cambridge University Press, 2004, page 114. Book not online.

<sup>67</sup> See Appendix V for copy of the bill.

<sup>68</sup> From a phone conversation with Miguel Palacios.

Laws also need to be in place to explicitly define how these contracts will be categorized so that institutional investors, who are only allowed to invest in certain types of instruments, can invest in them. This is obvious for private human capital contracts but may be relevant for states that look to private capital for some of the initial program funding.

## Risk of Default

Again, according to Palacios: “The protection that investors feel they have against default will be the main determinant of the success of HCCs. Default creates a leak to the high returns that can be obtained from investments in education. If the leak is too large or difficult to quantify, the opportunity for investment can vanish. However, with the proper legal environment or the support of the government, this variable can be brought to acceptable levels.”<sup>69</sup> Default risk is a similar problem for state-funded PIFs – programs would quickly become unsustainable if students do not pay what is owed.

High default rates were one of the factors that sunk the “Yale Experiment” due largely to a poorly designed risk-sharing mechanism that made each student responsible for the debt of the entire cohort but also because Yale administrators were not in an ideal position to be debt collectors. The states have more controls available than an individual firm or a college but most of their authority ends at their state lines. The state has agencies (both the Department of Revenue and ISAC are examples) that are very experienced with debt tracking and collection activities. Utilizing the state tax system would provide an avenue to get basic information, but having access to demographic information from the federal tax base would improve the potential to collect for the eight percent of students who leave Illinois upon graduation. One modification to the federal bills now being considered that would be helpful to legislators trying to develop state PIFs would be an explicit requirement for the IRS to provide basic information such as addresses to states seeking to track down PIF participants who have left the state.

## Paying for Pay It Forward

PIF program funding in the initial years is problematic due to the large investment required initially and the uncertainty of the future revenue stream. In Illinois, the maximum amount of potential revenue that would need to be replaced initially would be around \$1.2 billion at public universities and an additional \$0.9 billion at community colleges.<sup>70</sup> *That is for the first year.* The state would need almost as much the second year and considerable funding each year thereafter for at least 20 years. These numbers can be whittled down by making some behavior assumptions and restricting access to the program. While we will provide estimates in a later section of this report that are considerably lower than this for specific programs, it must be emphasized that one of the biggest hurdles to implementing a statewide PIF is the large cost to the state in the initial years.

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<sup>69</sup> *Investing in Human Capital*, by Miguel Palacios, Cambridge University Press, 2004, page 117.

<sup>70</sup> See Appendix IV a. and b. and c. *Setting a Context for Fiscal Year 2015 Budget Development*, IBHE Agenda Item, October 1, 2013. Exhibits 3 and 4.

There are many questions associated with how to fund the initial years of the program before sufficient revenue flows back into the program from program graduates in the workforce. Three of them often mentioned: what would happen to existing public investment at the state level; would existing grant aid be used to fund the program; and how are increases in college costs accommodated, have all been partially answered in the discussion above. For a Pay It Forward program to *not* move the Illinois higher education system to an essentially privately funded system, the current level of state funding, both direct funding and need-based grant aid, must be maintained or expanded. For a Pay It Forward system to be financially viable there must be strong controls on tuition and fee increases. Given these parameters as baseline and relatively fixed, many other questions still remain. Would “Pay It Forward” proposals be driven solely by public funds, or would private capital be allowed? Many combinations of public and private funding could be envisioned. Another important question is whether the existing mix of direct funding to schools and need-based grant aid still works with Pay It Forward. Existing grant aid could be modified and made to fit in well with a Pay It Forward plan to expand student funding options.

Aside from the state revenue generators – bonding and taxes – and private investment, another option has been mentioned for initial funding.<sup>71</sup> A Parents’ PIF would allow parents to prepay some percentage of a student’s college costs ahead of time and allow parents to share the cost of college with their children. When the student is in grade school, a parent could start PIFing a percentage of his income each year into the Higher Education Trust Fund. For each year PIFed, one year would be removed from the student’s PIF. If a parent started to PIF when his child was in 7<sup>th</sup> grade and continued to do so until the child graduated from college, he would have paid up 10 years of the student’s 25 year PIF. This would provide the state with some of the upfront funding it needs to begin the program and would reduce the student’s payment period by 40%.

Accountability mechanisms need to be in place to ensure college costs will not continue to go up and that students receive good value for their education. Without cost accountability, it is unlikely that “Pay It Forward” proposals could be brought to scale or maintained over the long run. College cost increases that overrun increases in family incomes will make PIF programs underfunded. Injecting private investment could provide some cost discipline. Well-priced, differentiated (by school and major) PIF contracts, possible with private investment and underwriting, could provide good information on the relative financial performance of different majors at different schools. However, some of the controls now in place could be lost with a Pay It Forward program. One accountability measure, the impact of high federal three-year cohort default rates (CDR) on schools’ eligibility for Title IV aid could be minimized under a Pay It Forward plan that reduced participant reliance on student loans.

The PIF proposals currently being considered in other states appear to have all of their funding coming from the state either through redirection of existing resources or from new revenue

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<sup>71</sup> From correspondence with staff at EOI. Based on the Washington GET program where parents by small units of college “credits” with 100 credits buying a year at the University of Washington.

sources such as bonds or new taxes. PIF proposals that cover large numbers of students are extremely expensive in the early years before repayment from students begin. A comprehensive PIF program also would require coordination among federal, state and, perhaps, private entities to fully operationalize the program. The federal government would need to provide assurances that income share agreements are valid, enforceable contracts; H.R.4436, with some modifications, may provide that assurance. It is also important for the federal government to clarify the tax treatment of different PIF models. Given that, a private market for ISAs could emerge and become a partner for state investment. The private sector is in the best position to accurately price the contracts. A “one-size-fits-all” PIF, a likely result from a state-funded PIF, is not as efficient as a differentiated PIF and does not provide one of the biggest benefits of HCC/ISAs – information about the success of a particular program, defined in financial terms. What private HCC/ISAs can do is identify areas of program imbalance – where the costs far outweigh the returns. By either not engaging in HCC/ISAs or charging high income percentages for some majors at some schools, private investors would provide clear signals as to the financial return a student could expect from these majors. For degrees where some of the benefits may be societal and not financial, such as elementary education, states could offer either a state PIF, provide a subsidy to the student to reduce the student’s other costs, or perhaps provide some type of guarantee that would reduce the risks of the PIF to the investor.

## Coordination with Other Financial Aid

Pay It Forward programs in other countries such as Australia include financing for expenses in addition to tuition and fees. With the exception of the California proposal that proposes to cover some of the non-tuition and fee related costs of college, U.S. states’ PIF proposals provide financing only for tuition and fees. For many students, tuition and fee charges, while substantial, are not their biggest financial hurdle. The full cost of attendance may include such charges as room and board, books, and transportation. Nationally, only approximately 39% of the cost of attendance would be covered by a PIF that covered only tuition and fees.<sup>72</sup> In Illinois, a PIF that covered tuition and fees would cover closer to 50% of the costs of a student attending a public university. How that other half of the cost is paid for can determine how workable and transparent a PIF program is. Pay It Forward programs can be very transparent in the sense that students know they will be able to pay regardless of how much they earn after college. However, if students have to take out additional loans, public or private, under different terms to cover expenses not covered by a PIF, the system may become more confusing than the current loan programs.

Under the terms of H.R.4436, the Investing in Student Success Act of 2014, PIF programs would not be used in the calculation of a student’s expected family contribution (EFC), the measure used to determine eligibility for Pell Grants. If this bill passes, students with a state PIF would still

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<sup>72</sup> *Trends in College Pricing*, The College Board, November 2014. <https://secure-media.collegeboard.org/digitalServices/misc/trends/2014-trends-college-pricing-report-final.pdf>

be eligible for a Pell Grant and subsidized loans if they were eligible prior to the implementation of a PIF.

The situation with MAP is not as clear. It has already been determined that cutting grant aid to lower-middle and lower income students results in reduced college participation rates for these students. Maintaining existing grant levels is important for at-risk student success. The MAP award could be used to reduce the per credit hour percentage on the PIF for that year or the grant program could be changed and MAP could be used to reduce the other costs of attendance.<sup>73</sup> Currently, MAP can only be used for tuition and fees, and is paid directly to the school on behalf of the student. Changes to MAP to make it more “Pell-like”, grant dollars that can be used for any cost associated with college, may, in combination with Pell and the campus-based, federal Work-Study program, enable students from lower income families to restrict undergraduate college financing to a single PIF for tuition and fees.

For middle income students who do not qualify for need-based aid, and whose families cannot cover the remaining cost of attendance, a loan in addition to PIF may be the only option. The federal government has many loan repayment options and loan forgiveness for some occupations. An Illinois PIF could be coordinated with at least the most common federal repayment option to offer a single repayment timeframe and keep payments manageable. A federal IBR with a graduated repayment plan could be coupled with a PIF that would keep the initial percentage of income devoted to college debt repayment small in the early years when incomes are smaller. The amount that would have to be borrowed through a federal loan or PIF would also be reduced if MAP were reconfigured to cover costs besides tuition and fees. Since about 14% of families with children in college now use high interest PLUS loans in addition to Stafford loans, just being able to eliminate the PLUS loan (or a private loan) would be a big step in middle class college affordability.<sup>74</sup>

Institutional aid also presents challenges. Under a PIF, students do not pay tuition and fees to the university until after they graduate so the concept of institutional aid would have to change. In addition to providing some need-based assistance, institutional aid is often used by institutions to help create the student body they want to serve at their institutions. Schools could continue this practice by allowing students a small discount on their PIF rate, or the institutions could be required to have a single price for all.

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<sup>73</sup> MAP is paid per credit hour but it only covers about a third of the cost of each credit hour at a public university. To use MAP efficiently with a PIF, the application of MAP would have to change. Right now, if a student’s semester tuition and fees for 15 credit hours are about \$6,500, MAP covers \$2,360 of it. The student either pays the residual himself (or has help from his family), uses his Pell Grant, and/or a student loan. Converting for a PIF, 36% of the credits (5) are covered by MAP; the rest (10 credits) would be PIFed.

<sup>74</sup> According to Awilda Rodriguez in *Access to What and for Whom? A Closer Look at Federal Parent PLUS Loans*, Center on Higher Education Reform, American Enterprise Institute, “In the 2011-2012 academic year about 13.8% of undergraduate students had parents who borrowed PLUS loans on their behalf. On average, the parents of undergraduates who borrowed accumulated \$19,310 in Parent PLUS loans.” Analysis of NPSAS:12 on PowerStats: <http://nces.ed.gov/datalab/powerstats>.

## Technical Issues: Program Implementation and Participant Repayment

There are many technical issues that must be worked out during the implementation phase of a Pay It Forward program. The two implementation issues mentioned most frequently are the use of different PIF rates by school or major versus a flat rate for all participating schools and the problem of accounting for student “swirl” – students who change institutions, often more than once, or students who drop out.

### *Uniform or Differentiated Payment Rates*

Should the payment rate or term of repayment for “Pay It Forward” students differ by college attended or major pursued? Private HCC/ISAs are structured differently for different schools and different majors based on the expected return from those degrees. But these HCC/ISAs are small, often involving a single school or a single major. Tying the parameters of an HCC/ISA to an individual school and major could result in thousands of possible outcomes with a statewide HCC/ISA for public institutions. The calculation of a payment rate is not simple and the computational challenges, including addressing the uncertainty of each calculation, would be huge.

When Australia began its program, it chose to keep it relatively simple. It used a set fee for all of its universities at about 25% of the average full-time higher education cost per student.<sup>75</sup> Australia was moving from a fully tax-funded system to a system with some private responsibility in an attempt to expand its higher education program and acknowledge a private benefit to education as well as a public benefit.<sup>76</sup> It structured its program as an Income Contingent repayment loan (ICL)<sup>77</sup> and set a payment schedule by taxable income. There was a range of annual repayment rates, the percentages of income required by the ICL, were initially set from 0 percent for incomes less than \$27,674, up to 5 percent for incomes of \$44,030 or more.<sup>78</sup> The fees and repayment ranges did not differentiate by major or school.

Since the Australian model was set up as a loan instead of an HCC/ISA, in addition to a repayment schedule, an interest rate had to be determined. Australia chose to keep the real interest rate zero (the interest rate was tied to inflation.) Because it was a loan, the length of payment time was set by the size of the loan. Payments would be made as long as the student had income and there was a loan balance.

In the first years of Australia’s HECS IDR-based student loan system, undergraduates paid about 23 percent of the average costs of study. The uniform tuition fee aspect was removed in 1997,

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<sup>75</sup> *Investing in Human Capital*, by Miguel Palacios, Cambridge University Press, 2004, page 135.

<sup>76</sup> For reference, in Illinois, the average higher education cost per student is \$13,427, of which \$3,678 is covered by the state subsidy, leaving \$9,749 in tuition and fees to be paid by the student. The tuition and fee portion represents about 73% of the education cost per student. IBHE data found in Appendix IV.

<sup>77</sup> In the U.S. ICL is known as an IBR or IDR.

<sup>78</sup> Australian dollars. The exchange rate at the time was about \$1.30 Australian per US \$1.00. The initial table had four levels: less than \$27,674, 0%; \$27,675-\$31,449, 3%; \$31,450-\$44,029, 4%; and 5% for incomes at \$44,030 or more. Palacios, *op. cit.* page 135.

and the HECS was “increased and differentiated into three cost bands based on a combination of the relative cost of course delivery and the relative profitability (the rate of return) of certain programs.” Reforms introduced in 2003 led to a partial fee deregulation that allowed institutions to set student contribution levels within a range from \$0 to a maximum set by the Australian government. Students who choose areas of study in Band 1 (social studies, humanities, etc.) fall within the smallest contribution range, followed by Band 2 (accounting, economics, etc.), and then Band 3 (law, medicine). Students have the option of paying a portion of their tuition fees upfront directly to the university to receive a discount, with the remainder of the payment deferred through a zero real interest loan provided by the government. Repayment via the taxation system begins once the student’s annual salary reaches a minimum compulsory threshold. Repayment rates, ranging from 4 to 8 percent, vary by income range, and increase with the student’s income.<sup>79</sup>

For the beginning stages of the complex endeavor of initiating a PIF program, keeping it as simple as possible has appeal. Doing so, however, reduces one of the principal benefits of an HCC/ISA, the assessment of the economic value of a educational program. College programs that are relatively expensive relative to their financial benefits upon graduation would have fairly high cost PIFs. Programs that produced good financial benefits relative to their costs would have lower PIFs. State financed PIF programs can be differentiated at some point. When over time, the state would begin to be able to determine which majors and schools produced the greatest financial returns based on the revenue streams it was receiving, it could further differentiate its PIFs as Australia did.

Differentiated PIFs could attract private investors. If an Illinois PIF were designed to include private investors, those investors would set the rates for the PIFs they would offer. These rates could provide guidance to the state which would sponsor the PIFs for the fields/schools that the private market would not sponsor. Since the absence of a PIF would indicate a financial disconnect – the program investment was too expensive relative to the increase in salary that would be obtained - the state could, over time, evaluate these majors at these schools and decide if it wants to continue to offer a PIF for students at those schools and in those programs. Societally beneficial programs may warrant continuation and perhaps a state subsidy to bring the costs more in line with the financial benefits; other programs may be left without a PIF, sending a clear signal to perspective students that the financial rewards to a particular degree are likely not to be in line with the costs of acquiring it.

### *Handling Student “Swirl”*

A PIF program based on credit hours, such as the one proposed by Oregon, would eliminate the accounting problems associated with changing majors, attending part-time, transferring to different colleges or dropping out. Students could PIF as many credit hours as they want; if they

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<sup>79</sup> *Higher Education and Cost Sharing in Australia*. University of Buffalo Graduate School of Education, The International Comparative Higher Education and Finance Project. Web. 5 Nov. 2014. <[http://gse.buffalo.edu/org/inthigheredfinance/files/Country\\_Profiles/Australia/Australia.pdf](http://gse.buffalo.edu/org/inthigheredfinance/files/Country_Profiles/Australia/Australia.pdf)>.

choose to go out of state to a different college without a PIF program, they would only pay for the credits PIFed in Illinois. For students who drop out, their PIF is based on the number of hours PIFed and, after a repayment grace period, their income would be assessed at the rate accumulated by the number of credit hours attempted. Students who attend two schools with different PIF rates/credit hour would simply sum them together. Examples are discussed below in the “How Would a Pay It Forward Program Work in Illinois” section of this report.

## *Repayment Issues*

While a pilot program is probably the best way to iron out the difficulties with the repayment process, several potential issues can be anticipated and addressed in this document. Being able to collect the payments is essential to a functioning PIF, either state-sponsored or private. High default rates would raise the cost of the PIF and make the program untenable for the state or uneconomic for the private investor or the student, who would be subjected to higher rates to cover the increased defaults.

This problem with repayment is troublesome to those now offering private HCC/ISAs and isn't confined to default: “The aspect of HCCs that is likely to raise the most concern among investors is the incentive that students have to postpone or hide their income. Postponing income can be done in so many different ways that no contract will be able to cover them all. Thus, the contract should explicitly state that any income derived from the student's productive efforts during the repayment period should be considered income for the purposes of determining the student's repayment obligations.”<sup>80</sup> This interpretation may be considered too broad by states. At the federal level, H.R. 4436 attempts to clarify what constitutes income and other basic parameters of an HCC/ISA contract. If passed, this bill should provide guidance. Most states have not specified the parameters of their proposed PIF programs to this level of detail. Oregon is one exception and proposes using state and federal AGI as the measurement of income.

We do not know how the default rate on PIFs would compare to the rates conventional student loans. Federal student loan defaults are the result of either an inability to pay or an unwillingness to pay or, in some cases, a lack of understanding of repayment options. With a simple PIF payment tied to income, default from inability to pay may be minimized. Also, the passive repayment nature of a PIF (the money could be deducted from a student's paycheck or an automatic withdrawal from a bank account) could help reduce the rate of default, although the annual recertification process would be complicated to work out. However, the absence of accruing interest penalties for nonpayment and the negative impact on a borrower's credit rating may reduce the willingness for participants to repay.

The federal government has had success with its passive loan repayment program. More than two million borrowers with Direct Loans have selected automatic payment where their banks automatically make payments to their loan servicers each month and receive a quarter percent

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<sup>80</sup> *Investing in Human Capital*, by Miguel Palacios, Cambridge University Press, 2004, page 118.

interest rate reduction to do so. Most PIF programs now require some form of mandatory passive repayment. Paycheck withholding, which is really just a form of worker-approved wage garnishment, is a form of passive repayment that has been used successfully for Australian and U.K. student loan repayment. However, the withholding from paychecks for non-defaulted student loans is not currently in place in the U.S., even for federal student loans. Also, despite the voluntary passive loan repayment approach, the three-year cohort default rate for federal student loans is close to 14%.

Whether requiring a passive repayment methodology simplifies or complicates student loan repayment depends on factors such as whether borrowers are employees for a firm or working as private contractors, have multiple jobs, and if their employers are able to administer such withholdings. And it is easier if the student stays in state to work. One of the most frequently asked questions about PIF repayment is: What happens when students leave the state after graduation? Another question usually follows: What happens if students drop out or never enter the workforce (stay-at-home mom, for example)?

In response to the question about PIF participants leaving the state after graduation, one can look to the current federal IDR repayment plans for Stafford loans. Currently, U.S. borrowers have to provide their income information to apply for IDR plans. Those already making income-driven payments are required to provide updated income documentation every year to continue making such payments; otherwise the monthly payment is increased to a 10-year standard payment.<sup>81</sup> Students who are enrolled in a state Pay It Forward Plan could be required to provide similar income information.

The payment mechanics from the Oregon proposal could be employed. The Oregon proposal sets payments by looking back one year. It would use Oregon AGI for its in-state program participants but would use federal AGI for out-of-state participants. After a six-month grace period, “contributions would be based on participants’ own estimated income. After the first tax return, for the next year contributions would be based on annual income from the previous year.”<sup>82</sup> The state tax return would be the official document for the process. Estimated income is compared each year to the information provided to the Department of Revenue. If PIF was underpaid, the PIF

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<sup>81</sup> Some borrowers can electronically transfer their tax information into an online form via the IRS’ Data Retrieval Tool (DRT), which has greatly streamlined the application and income recertification process. However, borrowers who recently filed a 1040 form may have to wait from two to 11 weeks to be able to use the DRT, depending on whether they filed electronically or by mail. Additionally, certain types of borrowers cannot use the DRT due to their tax filing status. Others cannot use the tool because they earn too little to owe federal income tax; the DRT is not designed to pull earnings data from W-2 or 1099 forms. Borrowers who are blocked from using the DRT must provide a paper copy of their tax form or a tax return transcript. Those who don’t file a 1040 or need to provide more recent income information than their latest tax return reflects must use a more burdensome “alternative documentation of income” process.

<sup>82</sup> *House Bill 3472: Pay It Forward*, 2014. A report to the Oregon Higher Education Coordinating Commission from the Pay It Forward Workgroup.

administrator can instruct the state revenue agency to add a deficiency to the participant's tax return for the previous year; if the participant overpaid, a credit would be added.

As to the second question about what happens when PIF participants don't join the workforce, the reasons for not joining or leaving matter. Obviously, students who cannot find work should not be paying anything for their PIF – this is part of the risk shift to the state or investors. For PIF participants who choose not to work, the Pennsylvania model, an IBR, assesses the monthly repayment based on half the previous annual taxable income. It may be possible that married PIF participants who choose not to work could be assessed on the joint income of the family.

Careful attention needs to be paid to the details and mechanics of collection to keep collection costs to a minimum and reduce potential defaults. Automatic enrollment through payroll deduction or through an automatic payment from a checking account would likely yield the best results. To automatically enroll borrowers in an HCC and automatically adjust their payments in response to changes in annual income, Illinois would need access to their tax records or other income information for the life of the loan. One potential mechanism would involve requiring borrowers to provide such access via the promissory note, as a condition of the loan. Borrowers' permissions could last for the entire repayment period or a smaller time frame subject to renewal.

Moving out of state provides additional challenges. Federal bill H.R. 4436 that has been introduced to help create the legal framework for ISAs could use a helpful modification to require the IRS to provide basic income and address data to states for the purpose of tracking PIF participants. Updated information is required annually and time and money will have to be dedicated to tracking down borrowers who decline or forget to update their information for automatic enrollment. Although the U.S. Treasury does assist with the collection of federal student loans through the offset of federal payments like tax refunds, it would be too much to expect it or the IRS to aid in collection activities for the state. However, the agencies may be more willing to provide basic home addresses, workplace addresses, and AGI upon request to states trying to track nonconforming PIF participants if it were explicitly required through federal legislation. About 92 percent of Illinois students who attend Illinois schools stay in Illinois upon graduation.<sup>83</sup> While 8 percent leaving the state is significant, it is manageable and many of the techniques currently applied in loan collection activities could be appropriate for defaulters who leave the state.

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<sup>83</sup> IERC data reported in *Outmigration and Human Capital: Homeward Bound or Gone for Good?* By Eric J. Lichtenberger and Cecile Dietrich. 2014.

## How Would a Pay It Forward Program Work in Illinois?

### For a Pay It Forward Program to be viable...

- 1 State funding cannot decline below current “baseline” levels**
- 2 Need-based grant aid must be maintained at least at existing levels**
- 3 State must exert some control over public university and community college tuition and fees**

There may be a way to obtain the benefits of a Pay It Forward program – the increased access to college, the reduced repayment risk for the student, and the possibility of more high school students attending college in the state – without the negatives attributed to these programs such

as a lack of transparency resulting in higher college costs, cost shifting among students and between the state and the students, lack of adequate controls on schools and increased financial aid complexity as students try to coordinate Pay It Forward with other programs.

The success of a Pay It Forward program is contingent on a relationship between college-educated workforce salaries and the cost of college attendance. Once a Pay It Forward program is in place, if the increase in the cost of college attendance continues to outstrip the increase in salaries for workers with degrees, Pay It Forward programs will not be viable. It is absolutely essential that college costs be contained. This means that the cost of attendance cannot increase beyond the rate of wage growth. Schools have to control costs and the state has to maintain, at a minimum, the current real level of support (increase support by at least the rate of inflation.) Additional state dollars flowing to the schools due to Pay It Forward have to be added to the current level of support; they cannot replace it. *Without control over public institution tuition and fees, Pay It Forward can't work on a broad scale.* Successful programs today are either small, highly targeted private programs or are run nationwide in countries where most students attend public institutions with tuition and fees set by the government.

In addition to maintaining state support and school cost control, the legal mechanisms must also be in place at the state and federal levels to ensure that these contracts are legal and enforceable. Beyond those basic requirements, the programs can be structured to meet additional state and student needs. This means selecting the financing mechanism and terms; determining the higher education sectors involved and the students who would be eligible; choosing the costs to be “PIFed” and the accounting methodology for tracking; and identifying the sources of funds to pay for the initial years of the program. Different choices can yield significantly different results.

### **Financing Mechanism and Terms**

Pay It Forward programs can use either an IDR/IBR or an HCC/ISA as the financial instrument. The IBR can contain loan forgiveness provisions. The Pennsylvania plan proposed uses an IBR with no loan forgiveness as does the Australian program. The federal PAYE IBR program contains loan forgiveness for students with lower paying jobs. Loan forgiveness

essentially combines a loan with a grant and benefits students who either borrow very large amounts or find lower paying positions upon graduation (or both).

The cost to the state and benefits of the program to participants are sensitive to the parameters of the loan: the interest rate, the time frame for repayment and any loan forgiveness provisions. Students in interest-charging IBRs without loan forgiveness who wind up in lower-paying jobs can pay far more for their education than students who receive higher paying positions upon graduation. The Pennsylvania program which uses an IBR, has some protection against interest accumulation. The loan has no interest, but a “default insurance fee” would be assessed. Depending on how that fee is collected, the Pennsylvania program could favor students who secure higher paying jobs upon graduation. Students in lower paying positions would have to pay more if the default insurance fee is assessed annually because it could take them much longer to pay off the debt.

The details are extremely important. In a PIF with an IDR/IBR instrument, if students pay until the principal and interest are recouped, there is no cross subsidy among students but those in lower paying occupations may wind up paying a great deal more for their education than students with higher paying jobs who can pay off their loans more quickly. If there is loan forgiveness or no interest charges placed on the loan, the student is receiving a subsidy that will not be recouped by other students paying more, and the state will have to find the dollars to pay for it.

HCC/ISAs have different distributional impacts. Students who benefit most from income share agreements are those who work in relatively low paying jobs upon graduation. Since there is no principal to be repaid and no danger of exploding compound interest, there is less total payment uncertainty to the participant with an HCC/ISA than there is with an IDR/IBR loan. The years of repayment are fixed and the percentage of income attached is predetermined. As with an IDR/IBR, the degree to which one group of students finances another and the degree to which the state finances the entire endeavor depend on the parameters of the HCC/ISA. Income caps to prevent high income graduates from paying substantially more for their education than graduates in lower paying jobs can cause program deficits that will have to be made up by the state. Similarly, PIF percentages that are set too low will also require the state to further subsidize the program. This may be acceptable or even desirable but it shouldn't be designed by default.

### *Determining the Sectors Involved and the Students Who Would be Eligible*

Pay It Forward programs in other countries are relatively straightforward because most of the education system is public. In Illinois, a significant percentage of students, about 35 percent, attend either a private non-profit or proprietary institution. Most of the state-sponsored PIF programs being evaluated focus exclusively on the public sector with the exception of California, which is considering a pilot program for students from a private institution. Privately funded PIFs are offered to students attending both public and private institutions. Since many private institutions in the United States offer an elite education, these students are perceived as good risks for investors.

The large scale of state-wide Pay It Forward programs make them very expensive even when only the public sector is involved. Also, as already noted, cost control is absolutely essential for a successful PIF, and states have more control over tuition and fees at public institutions than at private ones. Because of this, despite the large percentage of Illinois students who attend private institutions, the model described in this report simulates a Pay It Forward option only for students attending public universities and community colleges.

There are many ways to restrict eligibility for these programs beyond sector choice. It is also possible to make them mandatory, although no state program to date is proposing to do so. One universal restriction on the state proposed programs is state residency. Beyond that, some of the suggested programs are offered to all in-state students in the sector; others restrict eligibility, usually based on need. Pennsylvania is proposing a three-tiered system where the students from the lowest income families can PIF all of their tuition and fees while a student from a relatively high income family can PIF a third of the cost. The Michigan proposal caps participant eligibility at a family income of \$250,000 and the Washington proposal requires the program to serve a high proportion of low-income and traditionally underrepresented students, including first generation.

One would expect voluntary participation in these programs to decline as income rises and affordability becomes less of an issue. Participation in the program does not have to be “all or nothing.” Students could choose to PIF half their programs and pay for the other half.

Some states are proposing to require full-time attendance and have participants completing in four years to remain in the program. Other states are more flexible and creative. The Oregon proposal imposes time limits but is more generous – students could stay in the program (i.e., attend classes) for 10 years and could PIF up to 125% of their programs’ minimum requirements to graduate. Other requirements have been proposed. Michigan would add a GPA requirement – maintenance of a 2.5 GPA would be necessary to keep the PIF. In some states, such as New York, failure to meet the requirements of the program (including getting into repayment) would result in being removed from the program entirely and having the PIF converted to a traditional loan with interest.

The voluntary, open nature of the Oregon design provides the most flexibility for students and families of all the state programs yet proposed and this flexibility may be a good fit for Illinois’ mix of students. Illinois has a large number of adult learners who often attend part-time and face extreme financial hurdles to do so. Fully 40 percent of MAP recipients are independent students with few resources for college. Restricting a PIF program to full-time students would deprive a substantial number of Illinois’ neediest students from participating. The desire to restrict access to state programs seems to spring from the realization that a completely voluntary program is extremely expensive for any state. To restrict the cost of the program somewhat, eliminating students from families in the fifth income quintile who have little or no financial need, would help control costs without affecting college access.

Figure 5

## Creating a PIF Program

### Choose FINANCING MECHANISM AND TERMS

- IBR with Loan Forgiveness
- IBR without Loan Forgiveness
- HCC/ISA

*For IBRs terms include interest rate, minimum payment, maximum term (with loan forgiveness) and delinquency and default provisions. For the HCC/ISA, the terms include the percentage of income paid, and the number of years of payment. For both programs, a grace period needs to be established, current proposals range from 6 months to three years.*

### Choose ELIGIBILITY

- Mandatory
- Voluntary
- Restrictive
- Combination

*PIFs can be both voluntary and restrictive. For example, students from the highest income levels may be excluded from the PIF program but the program would remain voluntary for the rest of the students both as to whether to participate and the degree of participation.*

### Choose SECTOR

- Public 4
- Community College
- Private
- All Public
- All Sectors

*Most state PIFs are being considered as programs for students at public institutions only.*

### Choose COSTS "PIFed"

- Tuition and Fees
- All Costs
- Tuition and Fees and Some Costs

*Most state proposals PIF only tuition and fees. At community colleges, care must be taken to ensure continued full Pell-eligibility. The federal bill allows students to PIF costs up to the highest tuition and fee level at the most expensive public university in the state. Students attending lower cost state schools could PIF part of their other expenses under this proposal.*

### Choose ACCOUNTING METHODOLOGY

- Per Credit Hour
- Per Term or Year

*PIF accounting done per term or per year assumes full-time study and doesn't handle drop-outs and transfers easily (generally removes them from the program and converts their PIF to a loan.) The Oregon model accrues PIF by credit hour which enables students to PIF the hours they want and combine them with PIFed hours at other schools. Per term or year programs end after four or five years; Oregon's program extends for 10 years allowing part-time students to participate and allows students to return who failed to complete the first time.*

### Choose INITIAL FINANCING

- All Public
- All Private
- Public/Private Partnership

*Public financing includes reallocating existing revenues, taxes and bonding. Private funding would have investors doing the underwriting and setting the pricing for PIFs. Hybrid public/private financing is possible. Another possible funding source is a Parents' PIF which could begin before the student goes to college.*

### Choose COLLECTION METHODOLOGY

- Loans set up like Federal program
- HCC use payroll deduction or automatic transfer

*Student tracking and default prevention are important elements with either type of financing mechanism. Tracking some students may require federal assistance, however, approximately 92% of the students who attend Illinois schools remain in Illinois upon graduation.*

## *Choosing the Costs to be “PIFed” and the Accounting Methodology for Tracking*

Most of the proposed state programs restrict the PIF program to tuition and fees. The exception is California which may pilot a program that includes other costs. Australia’s program includes other costs and private PIFs sometimes do as well. An interesting twist is proposed by U.S. federal legislation S. 1884. It would allow other costs to be covered under a PIF up to the highest cost of tuition and fees of the schools participating in the program. For Illinois, this would mean that a student attending Western Illinois University, with FY2014 tuition and fees of about \$12,000, would be able to PIF up to about \$15,000 (the FY2014 base cost at University of Illinois Urbana-Champaign before tuition differentials) and receive \$3,000 toward his other costs of attendance. As already noted, implementing a PIF is an expensive proposition for the state, regardless of how it is done. Including additional costs to the program by PIFing other costs of college in addition to tuition and fees would be difficult. Perhaps a better way to handle other costs would be to ensure that state PIF programs align with the federal loan programs to enable students to meet all their costs.

Maintaining Pell eligibility could be a concern with a 100% PIF at community colleges. The “PIFed” amount would presumably be subtracted from a student’s cost of attendance (COA) and reducing tuition and fees to essentially zero could cause students to lose Pell eligibility. Pell eligibility is based on cost of attendance and a COA of less than \$5,730 for a full-time student results in a smaller Pell Grant. Costs appear to be high enough in Illinois so that a conflict is not obvious at this time but this threshold should be checked for each school if a program is developed.

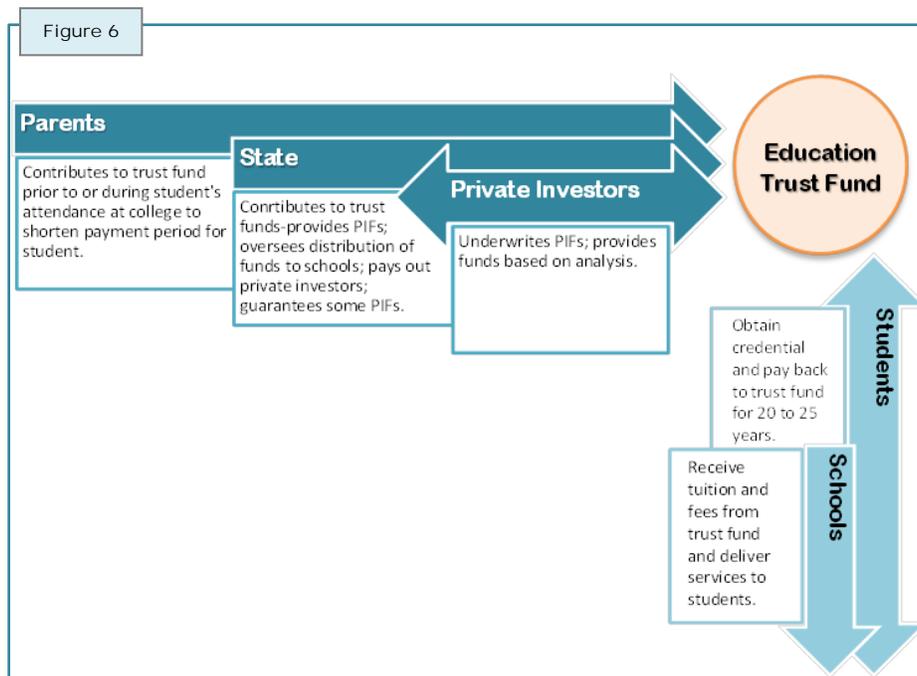
As already mentioned, Oregon has developed an elegant way to track PIF participation. Students would pay a tiny fraction of their income per credit hour amounting to 4% of their income for 180 quarter hours (This would convert to 120 semester hours in Illinois.) Using this “per credit hour” approach eliminates many of the accounting issues that have been brought up when PIF implementation is mentioned. Students who don’t complete pay a smaller fraction of their income than students who do. For example, a student who attended a four-year school full-time for a semester (15 hours) would pay 0.5% of her income in her PIF, compared to a graduate with 120 hours in her PIF who would pay 4.0% of her income. Students who transfer among colleges would pay the going percentage at each school (the percentages are lower at community colleges in the Oregon model.) The percentages are summed and that is the rate for the student’s PIF. A student who spent two years (60 hours) at a community college with a credit hour PIF of 0.00025 and two years at a public university (60 hours) with a credit hour PIF of 0.00033 would pay  $(0.00025*60) + (0.00033*60) = 0.015 + 0.02 = 3.5\%$  of her income in her PIF.

Other states such as Pennsylvania and Michigan appear to be accruing PIF credits on a semester or annual basis. The Oregon model seems much simpler, is more flexible and does not require full-time attendance. Students can participate in the PIF program for up to ten years. This would allow part-time students to fully participate in the program and, as already noted, would accommodate students who return to college after a hiatus.

## Identifying the Sources of Funds to Pay for the Initial Years of the Program

Although the issue of funding sources has been left for last, it is not least important. PIF programs are expensive in the early years and have considerable uncertainty surrounding the actual cost. Uncertainty can be reduced if pilot programs are implemented and estimates of participation rates and default rates are verified. *As has been stated before PIF costs will be in addition to existing level of state support – both direct support and grant aid.*

The methods of funding state PIF programs vary if they are mentioned at all in the state legislation. Michigan mentions funding from both public and private sources but is not specific. Oregon would issue bonds to pay for its \$25 million pilot program. Pennsylvania proposes to raise money from a natural gas severance tax – a five percent tax on every unconventional gas well in the state. Program participation would be based on need and the size of the program is bounded by the dollars received from the tax. Vermont would use funds from an existing Higher Education Endowment Trust fund. Washington would use money now devoted to need-based grants. For Illinois, depending on the size of the program, a mix of tax revenue and bonds would be a probable combination. However, there may be other options.



A private/public mix of funding could improve the efficiency of a state PIF and increase the information value to the student. Private PIFs are priced to reflect value – the relationship between the cost of the program and the returns. Using private underwriting to price PIF contracts could bring a sense of rigor to the process and enable students and the state to see which programs have the most financial value. If some programs are not “PIFable” by private standards or are priced too high (the annual percentage of income exceeds a certain percent) the state could either subsidize the private PIF, increase up-front need-based grant aid to the student to reduce the cost, or offer the PIF contract itself. Any of these options – would be worthwhile for professions that are considered necessary or in short supply by the state. But the state could also just do nothing to support PIFs

for other majors which would help students to see that the financial payoff to a particular degree was not there. At a single institution it would be possible to have privately funded PIFs, publicly funded PIFs, and majors where no PIF is offered at all.

If a voluntary state PIF program were established and students could PIF part of their tuition and fees each year, many parents would try to minimize the repayment burden on their children by picking up whatever upfront costs they could either with current income or savings. This could be made easier for parents if a Parents' PIF were included in the program. Parents could begin a PIF years before students were ready for school, reducing the number of years that students would have to pay their percentage of income after they completed their degrees. Parents could be allowed a lag period where they could pay a percentage of their income for ten years before their child graduates (both before the student enters school and during the years the student is enrolled), cutting the student's PIF repayment period. For example, on a 25 year PIF, a family could begin a PIF six years before a child starts school and continue through the four years of college attendance. The student could then pick up the PIF after graduation and would only be required to repay for 15 years.

A Parents' PIF is a similar concept to prepaid tuition programs. Many of these programs allow college to be purchased in semester increments. At least one state, Washington, has established a "small unit" program with even smaller increments available for purchase. It is called the GET program, through which parents can purchase college tuition and fees by credits for their children. A single credit costs \$177, and 100 credits purchases a year at the University of Washington.<sup>84</sup> A Parent's PIF would be based on a percentage of the parent's income. That percentage would be translated into credit hours depending on whether the student ultimately went to a two-year or four-year institution.

A Parents' PIF could work in a similar fashion. If the state PIF was 4 percent for students attending public universities and 2 percent for students attending community colleges, parents could PIF 2 percent of their income for up to ten years and reduce their child's PIF by 1 year for each year of the parents' PIF at a community college. If the child attended a public university instead of a community college, 2 years of the parents' PIF would be worth one year of the student's PIF. If the student left the state or failed to complete enough college to "use up" the Parents' PIF, the residual would be refunded.

Note that a Parent's PIF could theoretically make a state PIF program self-sustaining more quickly, since it would provide a source of income before the student is ready to repay on her own and, indeed, before she has even attended college to take advantage of PIF. However, it is unknown if many people would find a Parent's PIF attractive, particularly since there are likely to be college costs that are not covered by a PIF that parents may want to pay for. Also, such a program would require substantial marketing dollars to create awareness and to communicate the program.

All monies received through the PIF – proceeds from bonds, state revenues from taxes or redirected from other sources, private investment, contribution from Parents' PIF, and any

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<sup>84</sup> Details from email exchange with John Burbank at the Economic Opportunity Institute. November 12, 2014.

investment or interest income from these funds would be held in a state education trust fund. The trust fund would distribute the dollars to the participating schools to cover undergraduate instructional costs. It should also be noted that to the extent funding is provided by bonding or investors, there will be requirements to pay debt service or returns to investors that will reduce the pool of available dollars to continue the payment of future educational costs.

Financing a PIF program is critical to its success. Borrowing money through bonding is the easiest way but also the most expensive way to fund the program and increases the point where the program breaks even. A smaller pilot program might be funded this way initially but a complete public institution PIF in Illinois would likely need multiple sources of funding.

### ***Program Administration***

A PIF program has fairly high administrative requirements. The program initially must be cost out requiring actuarial assistance. The example provided in this document uses the best data and methods available in the time allotted, yet can only be considered a rough estimate of costs. Both data collection and more rigorous data analysis would be needed to determine the cost of the PIFs. Using private underwriting would be one way to gain confidence in cost assessments but the addition of a private partnership to the basic PIF model creates other complexities.

Students have to be identified and tracked throughout their college going years and for up to 25 years beyond that. Tracking students through the school years has become easier and it should be fairly straightforward to accumulate PIF credits, even from multiple schools. Through the MAP grant and other programs, the state has over 50 years of experience tracking grant program participation.

Once a student leaves school, a payment program needs to be established. There are state protocols in place for this type of relationship with students. There are state college grants, including some administered by ISAC, that turn to loans if certain conditions aren't met. The state (again, through ISAC) has also been a servicer and guarantor for student loans for decades until the federal program ceased making new loans in 2010. The guarantor's responsibilities have included efforts to minimize defaults on loans and default prevention and collection procedures are already in place. There are also agencies in the state with decades of experience tracking students or workers for one reason or another and it is known there are significant economies of scale to administering these types of programs once the initial process is set up.

Since the private HCC/ISA programs are very small and no state has actually implemented a program, it is difficult to accurately gauge the cost. Australia's costs are estimated to be less than 5 percent of the annual receipts from the program.<sup>85</sup> Australia has two decades of experience

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<sup>85</sup> *The Australian University Student Financing System: The Rationale for and Experience with Income-Contingent Loans* by Bruce Chapman, in *Financing Higher Education and Economic Development in East Asia* edited by Shiro Armstrong and Bruce Chapman, 2011.  
<http://press.anu.edu.au/apps/bookworm/view/Financing+Higher+Education+and+Economic+Development+in+East+Asia/7301/Text/ch05.html>

administering the program and can use its central tax system to track program participants. Oregon estimates the administrative costs of its pilot program to be less than 1 percent over the pilot evaluation period<sup>86</sup> but they don't seem to have included any tracking and collection costs. Start up years generally require more staff time than subsequent years, and experience and better data integration will drive the cost downward over time. Probably an initial cost of one to two percent of the volume would be a better initial estimate, with the percentage to decline as the program ramps up. If a pilot program is implemented, many of the start up costs of the program will need to be paid for during pilot development. For example, legal and actuarial analysis, process development, and technical system enhancements would all have to occur and be paid for regardless of the size of a new program. The administrative costs for a pilot program would therefore seem very high on a per participant basis. These start-up costs will be about the same regardless of program size.

### Setting the Baseline

In order to evaluate the impact of Pay It Forward on students, schools and the state, it is necessary to establish a financial baseline. This baseline provides some detail on the total cost of undergraduate instruction in Illinois and the share of those costs assumed by students, parents, the state, the federal government and the schools.

The average total cost of four years at a public university is about \$117,000 including the state subsidy. The cost is split among many players in higher education: the student and the student's family; the state through direct grant aid and the school subsidy; the federal government through Pell and other grants and tax credits, and the schools themselves which provide some need-based and merit aid to students. Who pays what differs greatly by quintile.

Table 1					
Cost of Attendance by Income Quintile - includes initial debt but no interest					
Four year cost without debt interest	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
<b>Total Cost</b>	<b>\$ 116,752</b>				
<b>Family/Student Contribution</b>	<b>41%</b>	<b>46%</b>	<b>58%</b>	<b>69%</b>	<b>73%</b>
<b>State Contribution</b>	<b>29%</b>	<b>29%</b>	<b>13%</b>	<b>13%</b>	<b>13%</b>
<b>School Contribution</b>	<b>11%</b>	<b>11%</b>	<b>21%</b>	<b>10%</b>	<b>6%</b>
<b>Federal Contribution</b>	<b>19%</b>	<b>14%</b>	<b>9%</b>	<b>9%</b>	<b>9%</b>

As shown in Table 1 and illustrated in figure 7, the allocation of costs appears reasonable assuming an "ability to pay" model. After four years, the percentage of the total cost of a student's education borne by the parents and the student ranges from 41 percent for students from families in the lowest income quintile to 73 percent for students from families in the highest income quintile. The state provides 13 percent of the funding through the direct school subsidy and then provides additional aid, 16 percent of the total cost to students in the lower two quintiles through

<sup>86</sup> House Bill 3472: Pay It Forward, 2014. A report to the Oregon Higher Education Coordinating Commission from the Pay It Forward Workgroup, page 9.

the MAP grant. The federal contribution declines as income rises with the students in the lower quintiles receiving Pell grants and students in the upper quintiles receiving tax credits. Institutional aid is the smallest, most variable and the hardest to determine. One estimate of institutional aid has the middle income student receiving the most. Since institutional aid is a combination of merit and need-based aid, students from middle income families probably qualify for both, especially since academic preparedness increases with income and middle income families receive very little need-based aid from the state or federal government.

But the initial dollars paid do not tell the whole story. The family/student contribution often comes largely or solely from loans, some of them the high-priced federal PLUS loans and other even higher priced private loans. The percentage of costs paid by loans also differs by family income levels with middle income families covering more of the costs, 33 percent, with loans than other families. Depending on the time frame of repayment of these loans, dictated in part by the income students receive from working upon graduation, the “who pays for what” picture can change considerably.

As shown in the example displayed in Table 2, students pay anywhere from \$116,752 to \$137,501 for the same four-year education.<sup>87</sup> These estimates understate the true cost differences among family income quintiles because the analysis does not include parent PLUS loans and the average loan debt has been treated as Stafford subsidized loan debt, which has the lowest interest rate and possibility of loan forgiveness. Up to 20 percent of total loan debt now is estimated to be private, high cost debt with no loan forgiveness provisions. The variation in the amount paid, over \$20,000, is the result of different student family incomes and different salaries in post-graduation jobs that result in different loan payback options for different amounts of student loans. The example assumes that each student has selected a student loan option that results in monthly payments that are equal to or less than 10 percent of his monthly post-graduation income and minimizes the amount of interest paid.

The family/student contributions (including loans) vary from \$50,166 for a student from a very low income family who enters a lower paying job upon graduation to \$85,394 for a student from a high income family who does not utilize loans to cover the cost of attendance. But in between the two endpoints are some anomalies. Third income quintile families receive little state or federal need-based aid to offset the initial costs and often borrow heavily to put their children through college. If their children subsequently choose professions where the pay is relatively modest but not low enough to qualify for loan forgiveness in the federal IBR program, these families may pay more for their children’s educations than wealthy families do for theirs.

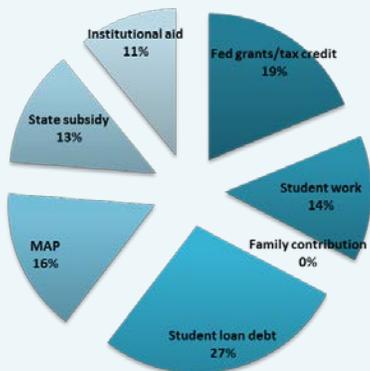
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<sup>87</sup> Based on the Integrated Postsecondary Education Data System (IPEDS) FY2013 total cost of attendance numbers for Illinois. Assumes graduation in four years. Assumes students borrow sufficient Stafford subsidized loans to cover remaining costs after grant aid

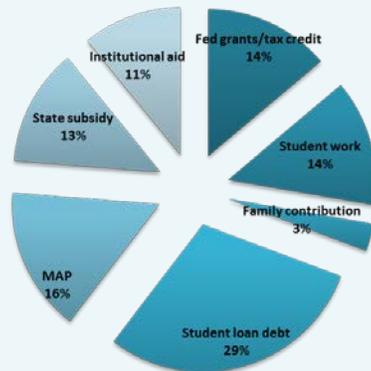
Figure 7

**BASELINE: Who Pays for College**

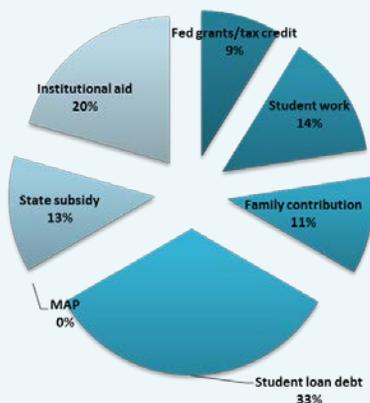
**Lower-Income Families**



**Lower-Middle Income Families**

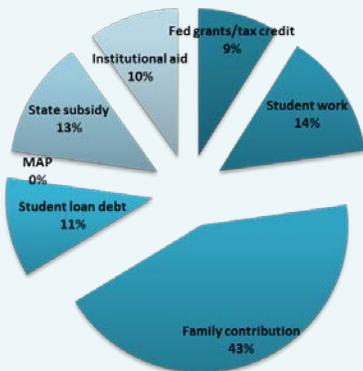


**Middle Income Families**



	Student/ Family	State	Federal	Institution
Lower-Income	41%	29%	19%	11%
Lower-Middle	46%	29%	14%	11%
Middle	58%	13%	9%	21%
Upper-Middle	69%	13%	9%	10%
Upper-Income	73%	13%	9%	6%

**Upper-Middle Income Families**



**Upper-Income Families**

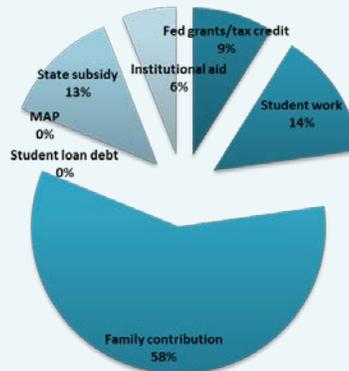


Table 2

<b>Cost of attendance - including subsidy, initial debt and total interest paid (no NPV)</b>					
	<b>Student Family Income</b>				
<b>Starting Salary \$20,000-\$29,999</b>	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
<b>Total Cost</b>	<b>\$ 118,506</b>	<b>\$ 116,182</b>	<b>\$ 111,706</b>	<b>\$ 120,035</b>	<b>\$ 116,752</b>
<b>Family/Student Contribution</b>	<b>\$ 50,166</b>	<b>\$ 53,202</b>	<b>\$ 62,962</b>	<b>\$ 84,095</b>	<b>\$ 85,384</b>
<b>Starting Salary \$30,000-\$39,999</b>	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
<b>Total Cost</b>	<b>\$127,315</b>	<b>\$ 127,880</b>	<b>\$ 133,501</b>	<b>\$120,035</b>	<b>\$116,752</b>
<b>Family/Student Contribution</b>	<b>\$ 58,975</b>	<b>\$ 64,900</b>	<b>\$ 84,757</b>	<b>\$ 84,095</b>	<b>\$ 85,384</b>
<b>Starting Salary \$40,000-\$59,999</b>	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
<b>Total Cost</b>	<b>\$125,026</b>	<b>\$ 125,619</b>	<b>\$ 126,761</b>	<b>\$120,035</b>	<b>\$116,752</b>
<b>Family/Student Contribution</b>	<b>\$ 56,686</b>	<b>\$ 62,639</b>	<b>\$ 78,017</b>	<b>\$ 84,095</b>	<b>\$ 85,384</b>
<b>Starting Salary \$60,000-\$79,999</b>	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
<b>Total Cost</b>	<b>\$125,026</b>	<b>\$ 125,619</b>	<b>\$ 126,761</b>	<b>\$120,035</b>	<b>\$116,752</b>
<b>Family/Student Contribution</b>	<b>\$ 56,686</b>	<b>\$ 62,639</b>	<b>\$ 72,996</b>	<b>\$ 84,095</b>	<b>\$ 85,384</b>

Once of the highest family/student contributions can be found for a graduate from a middle income family who takes a relatively low paying job upon graduation. This student was too “wealthy” to qualify for grant aid so the upfront costs of college were not reduced by much. Upon graduation the student was hired for a job that paid \$35,000 annually. That salary was too high to qualify for loan forgiveness under the PAYE program. Had she selected the PAYE option she would have had reasonable payments but would pay a large amount of interest. Another federal IBR program would allow her to make minimum payments that were less than 15% of her income. But this program also came with no loan forgiveness and an extended repayment period resulting in the accumulation of large amounts of interest, although less than the PAYE program. This combination of being initially too “wealthy” for grant aid and not quite poor enough upon graduation for loan forgiveness, results in a total student/parent payment of \$84,757 – almost the same as the student who came from a family with four times the wealth and entered the job market at a salary twice as high. Clearly the current combinations of federal, state and institutional aid coupled with a variety of federal loan programs produce some inconsistent results.

There are caveats associated with this analysis. The net present value of the loan payments was not considered. However, PLUS loans were also ignored. Many families, especially those in the second, third and fourth income quintiles, can pay only a very small fraction of their calculated EFCs, making up the difference with parent PLUS loans at 7.21 percent. Currently 14 percent of students’ families take out PLUS loans. With an average balance of \$19,310 they are now a

significant portion of higher education financing<sup>88</sup>. That \$19,310 balance balloons to \$26,666 with a ten year repayment period.<sup>89</sup> It also was assumed that the total loan debt was Stafford subsidized debt at a relatively low interest rate of 4.66%. Roughly 20 percent of the debt that four-year school graduates have comes from private loans<sup>90</sup> with much higher interest rates and no loan forgiveness.

The status quo is not always producing the financial outcomes expected or desired. The various federal and state grant and loan programs do not always produce an intended, fair outcome. The process is complicated and requires a combination of loans and grants to yield a workable solution. Students from lower income families now have to cobble together MAP, Pell, institutional aid, Federal Work Study and a Direct Loan to get through. Students from middle income families don't receive MAP and Pell, but have to rely on institutional aid and loans from a variety of sources: Stafford subsidized and unsubsidized, federal PLUS loans and private loans, as well as second mortgages and credit cards in some cases. If structured properly, adding a state sponsored PIF could substitute for a federal loan for a lower-income family and replace some of the more expensive debt instruments (PLUS loans, private loans, credit cards) from the middle income family's portfolio of options.

The current grant and loan options often leave students from middle class families, who take moderately paying jobs upon graduation, paying more for their education than anyone else. The combination of being too "rich" for need-based grant aid and then too "rich" again for loan forgiveness (reserved for students who accept very low paying jobs upon graduation) has them paying far more in total for their education, with most of it coming from their own pockets.

### *Bounding the Costs*

Costing out a Pay It Forward program is difficult because of the large number of assumptions that have to be made about student attendance patterns, parent and student reception to the program that will determine their participation rates, the determination of the cost of undergraduate education, and other factors. The Illinois Board of Higher Education's (IBHE) table detailing the full undergraduate instructional costs per full-time-equivalent (FTE) student is a good place to start<sup>91</sup>. For FY2013, total FTE at public universities was 136,614. The total support for a FTE public university student in FY2013 was \$13,427, with \$9,749 coming from tuition and fees and the remaining \$3,678 provided by the State<sup>92</sup>. Multiplying total FTE (less the 6,248 non-

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<sup>88</sup> *Access to What and for Whom? A Closer Look at Federal Parent PLUS Loans*, Center on Higher Education Reform, American Enterprise Institute.

<sup>89</sup> Federal loan calculator. Calculations based on a \$60,000 joint income and three person family. The lowest total interest rate option was the standard repayment option of \$222 per month.

<sup>90</sup> *Student Debt and the Class of 2013* by Matthew Reed and Debbie Cockrane. November, 2014. The Institute for College Access and Success (TICAS)- The Project on Student Debt.

<http://projectonstudentdebt.org/files/pub/classof2013.pdf>

<sup>91</sup>Table 1: Fiscal Year 2013 Full Undergraduate Instructional Costs per FTE Student, Weighted Average Tuition and State Undergraduate Tuition Subsidy, and Fiscal Year 2013 Undergraduate Instructional Costs, IBHE calculations, see Appendix IV.

<sup>92</sup> IBHE calculations, see Appendix IV.

residents<sup>93</sup>) by undergraduate full instructional cost per FTE student yields a total undergraduate instructional cost of about \$1.8 billion. The total tuition subsidy provided by the State is about \$500 million and MAP covers an additional \$154 million, leaving about \$1.2 billion in tuition costs that would need to be covered each year at public universities alone if all Illinois students attending them participated in the PIF and the institutions' budgets were kept whole through additional state support.

The PIF program that will be described is measured in credit hours where students can choose how many of their credit hours they want to fund through a PIF program. Since some families are willing and able to contribute some support, many students who would be participants in PIF will not choose to fund all of their hours through PIF and some won't participate at all. Families in the fifth income quintile, with incomes in excess of \$110,000, often do not have financial need (as determined by the federal analysis) and they likely will either not participate or can be excluded from participation. If families in the third and fourth income quintiles choose to pay out half their EFC rather than financing that portion of costs through a PIF, it would significantly reduce the amount of PIF dollars the state must provide.

In the statewide model, it is estimated combining these mitigating factors could reduce the initial cost of a PIF at public universities by roughly half – to about \$670 million. The way a PIF program treats need-based aid affects the outcome as well. About \$154 million in MAP dollars goes to universities to defray costs for low-income students and an additional \$236 million in Pell goes to students at public universities as well. If these dollars continued to be used to reduce tuition and fee obligations for lower income students, more of the cost could be reduced. Under the most generous assumptions, it is estimated that a PIF program at public universities could cost as “little” as \$400 million during the first year.

However, if MAP were restructured to pay for ancillary costs and Pell grants were given to the students to pay for room, board, transportation and books, lower income students might be able to finish college with no Stafford loans. This would raise the cost of a PIF program back into the \$700-\$800 million range.

A community college PIF could also be costly. The total amount of tuition and fee revenue that the State would have to make up initially would be about \$850 million at community colleges if 100 percent of students participated fully. Approximately 30 percent of community college students are classified as pre-collegiate or continuing education. Excluding these students from PIF lowers the estimate in the statewide model to approximately \$665 million. Excluding students from families with incomes in the fifth quintile, and assuming families in the third and fourth quintiles would pay rather than PIF one-half of their EFC, reduces the estimate to approximately \$560 million. The model assumes fewer students from the higher-income quintiles at community colleges than it does at public universities.<sup>94</sup> Thus, the estimated savings from lowering the amount

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<sup>93</sup> IPEDs fall 2012 enrollment numbers, see Appendix VI. Non-residents are assumed to be full-time.

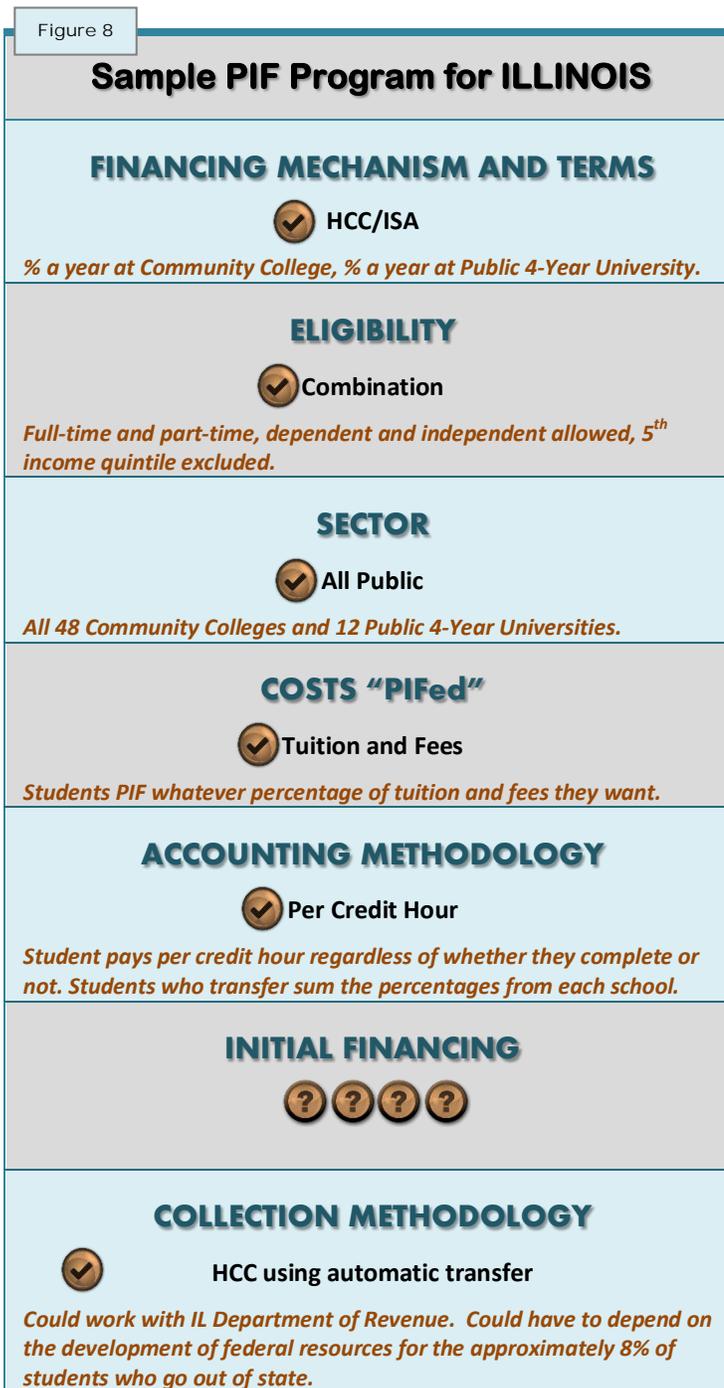
<sup>94</sup> Based on income and school choice data from ISAC analysis of Illinois FAFSA applications and IPEDS data.

available to PIF at community colleges for families in the third through fifth income quintiles are not as dramatic as the estimated savings at public universities.

Students in the first two income quintiles receive Pell grants in excess of tuition and fees at community colleges. The total Pell dollars going to students at community colleges is about \$435 million. If students applied half of their Pell grants to their tuition and fees, that would cover about \$215 million from the \$560 million, leaving \$345 million. MAP grants would cover another \$50 million, leaving \$295 million. Many students attend community colleges part-time and may not want to enter into a PIF for only one or two classes. These students could also be excluded from the program, which would likely reduce the amount to be included. This amount, however, would be difficult to project using the statewide model since it was based on FTE enrollment.

Overall, it is estimated that providing PIF programs to students at both public universities and community colleges, and allowing them to use the amount they currently receive from Pell and MAP grants for costs other than tuition and fees could cost as much as \$1.2 billion per year during the initial years of the program. PIF programs could be confined to a single sector – either public universities or community colleges –reducing the estimated costs to those discussed above.

*The statewide model used to estimate these costs is rudimentary, and cost estimates would need to be re-visited by qualified consultants before the state could implement a PIF, but it is a ballpark estimate and can give policy makers a rough idea of the magnitude of the financial commitment needed to implement a PIF in Illinois.*



An annual estimate of the cost of a Pay It Forward program depends on the parameters of the program – what the current tuition and fees are; whether the program is a human capital contract or an income-based repayment loan; whether it is offered to everyone or just a pilot group or just community college students or some other group; whether it is an “all or nothing” proposition or if partial contracts are available; whether an “opt-out” provision is included, and, of course, the payment terms. One state is considering piloting a program with as little as one thousand students involved at a cost of about \$7 million dollars during the first year.<sup>95</sup> But it is a very small program, that when ramped up to 4,000 by the fourth year costs \$20 million and has a break even point only after 21 years. In general, state PIF programs require large amounts of up-front funding.

## **A Model of an Illinois Pay It Forward Program**

### *The Parameters of the Program*

In order to model estimates for the annual cost and revenue for PIF scenarios, a sample voluntary PIF program was developed that included an HCC/ISA as the financing mechanism, included students from both public universities and community colleges, and excluded students from families in the fifth income quintile. Participant could PIF as many credits as they wanted and the PIF was based on full tuition and fees *without* subtracting MAP and Pell funds. These funds would be retained by the student to cover other costs of attendance. This would require legislative changes for MAP, which currently can only be used for tuition and fees.

A modeling cohort of students was constructed. The model was based on full-time equivalent (FTE) enrollment to account for part-time students. IPEDS<sup>96</sup> fall enrollment data for Illinois community colleges and public universities was extracted for Fall 2008 through Fall 2011. For public universities, graduate enrollment was excluded. For community colleges, Pre-Collegiate and Continuing Education enrollments were excluded.

Once the estimated FTE for each institution was established (see Appendix VI-A) for calculations), the number of FTE in different income categories was estimated. This was done in case state, federal, and institutional aid changed the amount of the PIF at different income levels. Participation rates were allowed to vary at different income levels either because of program design or family financing decisions.

The model’s retention rates are based on IPEDS data. IPEDS reports retention rates for the full-time, first-time degree certificate seeking undergraduate students (it’s GRS cohort) for the next year. These students represent only a portion of students at each institution, and for some

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<sup>95</sup> House Bill 3472: Pay It Forward. A report to the Oregon higher Education Coordinating Commission from the Pay It Forward Workgroup. 2014.

<sup>96</sup> The federal Integrated Post Secondary Data System (IPEDS).

institutions with large part-time enrollments, only a small portion. However, for purposes of the modeling cohort, these continuation rates were used to estimate the number of FTE sophomores which would be used in the modeling cohort.

IPEDS also reports graduation rates for the GRS cohort at 100%, 150% and 200% of the “normal” time to complete a degree – two years for an Associate’s Degree and four years for a Bachelor’s degree. These rates were used to estimate the proportion of the modeling cohort who would complete certificates or degrees to estimate revenue from completing students.

In order to estimate the earnings for graduates and non-completers, IPEDS data showing degrees and certificates conferred by institution, program, and award level were averaged for 2010 through 2013. The program and award level were matched with income data for certain jobs from the Illinois Department of Employment Security (IDES) to determine income level for graduates. The income levels were divided into three categories by IDES: 1) beginning, 2) median, and 3) experienced. Once average incomes were established for Entry, Median, and Experienced levels for each program and award level, a weighted average was calculated for each award level. The average for each program and award level as well as the weighted average for each award level is also shown in Appendix VI-B. Incomes for college drop-outs were assumed to be 90 percent of the incomes of those who completed a one-year certificate.

Using the retention rates from freshmen to sophomores, graduation rates, and degrees conferred, a distribution of the FTE modeling cohort was created. The estimated distribution for the cohort of FTE students who would be enrolled in any given year and potentially be eligible for a PIF is in Table 3.

<b>Class Level</b>	<b>Estimated Number</b>	<b>Percent of Original Freshmen</b>
Public University Freshmen	33,280	100%
Community College Freshmen	122,045	100%
Public University Sophomores	25,407	76.3%
Community College Sophomores	71,405	58.5%
Public University Juniors from Universities	20,881	62.7%
Public University Juniors from Community Colleges	29,582	24.2%
Public University 4 <sup>th</sup> Year Seniors from Universities	18,482	55.5%
Public University 4 <sup>th</sup> Year Seniors from Community Colleges	26,183	21.5%
Public University 5 <sup>th</sup> Year Seniors from Universities	7,789	23.4%
Public University 5 <sup>th</sup> Year Seniors from Community Colleges	11,034	9.0%

The modeling cohort also contained a distribution of PIF recipients who might be paying in any given year. This distribution is shown in Table 4.

Table 4

<b>Group</b>	<b>Estimated Number</b>
Public University Freshmen Drop Outs	7,873
Community College Freshmen Drop Outs	25,382
One-Year Certificate Earners	25,258
Public University Sophomores Drop Outs	4,526
Community College Sophomores Drop Outs	4,194
Community College Transfers to Public Universities	29,582
Two-Year Certificate Earners	6,699
Associate's Degrees	30,930
Public University Junior Drop Outs from Universities	2,399
Public University Juniors Drop Outs from Community Colleges	3,399
Public University 4 <sup>th</sup> Year Senior Drop Outs from Universities	4,323
Public University 4 <sup>th</sup> Year Senior Drop Outs from Community Colleges	6,124
Bachelor's Degrees in Four Years from University Students	6,370
Bachelor's Degrees in Four Years from Community College /University Students	9,025
Bachelor's Degrees in Five Years from University Students	7,789
Bachelor's Degrees in Five Years from Community College /University Students	11,034

Once the estimated distribution of students who would be potential PIF recipients (and who could potentially cost the program) and the estimated distribution of groups of people who were no longer enrolled (and who could potentially provide revenue to the program) were determined, a model was constructed which rolled in participants on a yearly level – freshmen in year one, freshmen and sophomores in year two, etc.

In the model, it was assumed that different income quintiles might participate in a PIF program at different rates. For example, students from families with incomes in the fifth income quintile would be excluded from participation to reduce costs. It was also assumed that the students from families in different income quintiles might choose to enter into a PIF for a different proportion of hours enrolled. It was also assumed that the amount of the PIF for a full-time student could vary for students from families in different income quintiles. For this simulation students from families in the fifth income quintile were excluded because they have no federally calculated financial needs; students from the third and fourth income quintiles reduced their PIF by half their EFCs showing some parents' contribution. These parameters can be viewed in Appendix VI.

The costs to be PIFed that would have to be made up by the state in the early years of the program were the undergraduate instructional costs per FTE of \$9,749 for students at public universities and the mean weighted average tuition and fees of \$3,626 for students at community colleges.

In the model, a 10 percent default rate was assumed. It was also assumed that a certain percentage of those scheduled to be in repayment would be unemployed. Unemployment rates for those just entering the workforce were higher than those who had been in the work force six years or fewer, and rates for those who had worked between six and twelve years were higher than those

who had worked at least twelve years. The unemployment rate for entry-level drop outs was set at 18% (with all others computed from that assumption). These parameters can be viewed in Appendix VI.

Although a factor was used to convert part-time students to full-time students in the FTE cohort, the average number of credit hours full-time students completed each year could not be determined. For modeling purposes, a range was created and the mean of this range was used. The minimum, maximum and mean number of hours for each cohort in the Model are shown in Appendix VI.

Despite all of the potential problems in estimating cost and revenue for a PIF program in this model (and there are a number of places where assumptions can be second-guessed), if the PIF changes enrollment or graduation rates, the potential for actual costs to vary from those estimated is even more pronounced.

Rather than change the income used in the model in the out years, an income growth factor was computed based on the assumption that people would reach the median income about their 11th year of employment and the experienced income about their 20th year employment for each of the different degree types. All are approximately three percent though there are slight variances by each type. The calculations are found in Appendix VI.

### *The Results of the Simulation*

Oregon estimated that students would need to pay 0.0222 percent of their income for each quarter credit hour earned at public universities and .0167 percent of their income for each quarter credit hour earned at a community college for their program. This would result in about 1.5% of income being PIFed for a student earning an associate's degree and about 4% for students earning bachelor's degrees. Under the conditions just specified and using Illinois costs, students earning bachelor's degrees would pay 0.0004095% per semester credit hour resulting in 4.9% of income being PIFed for 20 years for a 120 credit hour bachelor's degree. For students receiving associate's degrees, the PIF percent is 0.0002248 per semester credit hour resulting in a 1.3% PIF for a 60 hour degree. The PIF percentage for a "two-plus-two" bachelor's degree (two years at a community college and two years at a public university) would be 3.8%. All details plus the results of a 25 year PIF, which would reduce the percentages to 3.4% for a four-year bachelor's degree, 2.7% for a two-plus-two bachelor's degree and 1.0% for a two-year associate's degree, are shown in Appendix VI.

As shown in Figure 9, the program is expensive. This is a 20 year PIF program. Since it would be phased in, starting with freshmen, the maximum annual cost is reached at Year 5, with an estimated cost to the state of over \$1.2 billion and little revenue from repayment coming in to offset the cost. The annual net cost is over \$1 billion for four of the first ten years of the program and the program operates in the red for 19 years. The program should change from net cost to net revenue at Year 20 but it would be many more years before revenues offset the initial cost.

Figure 9

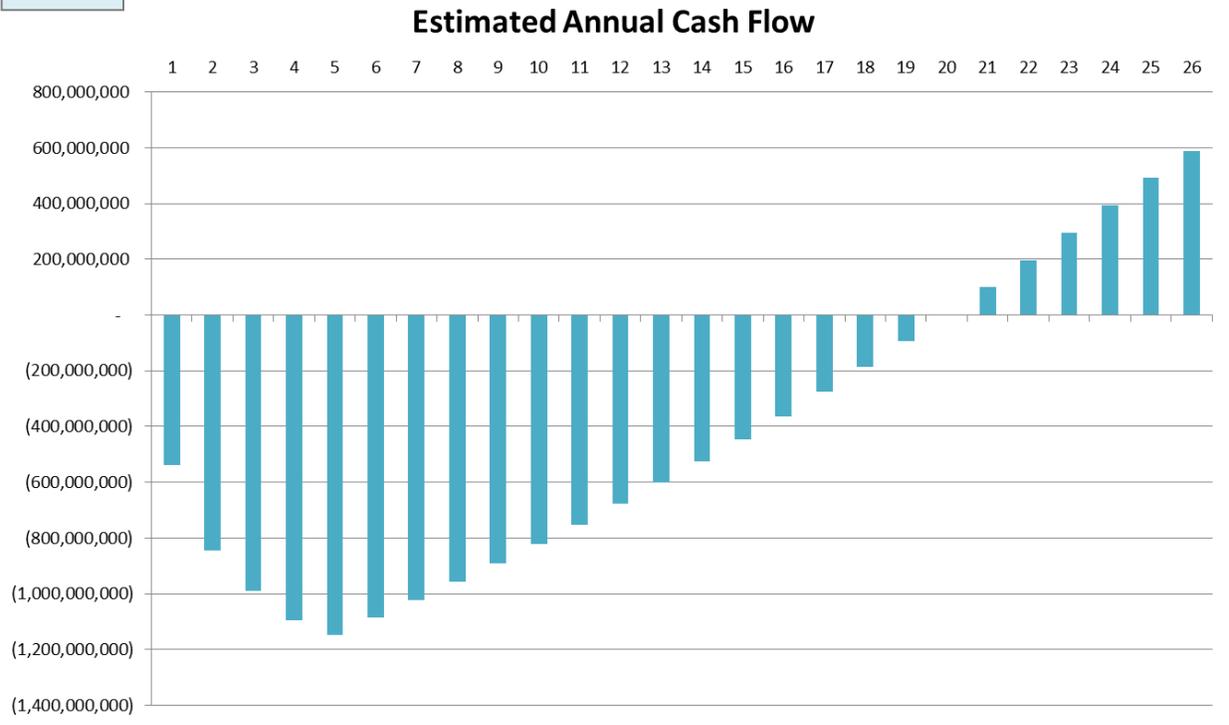


Table 5

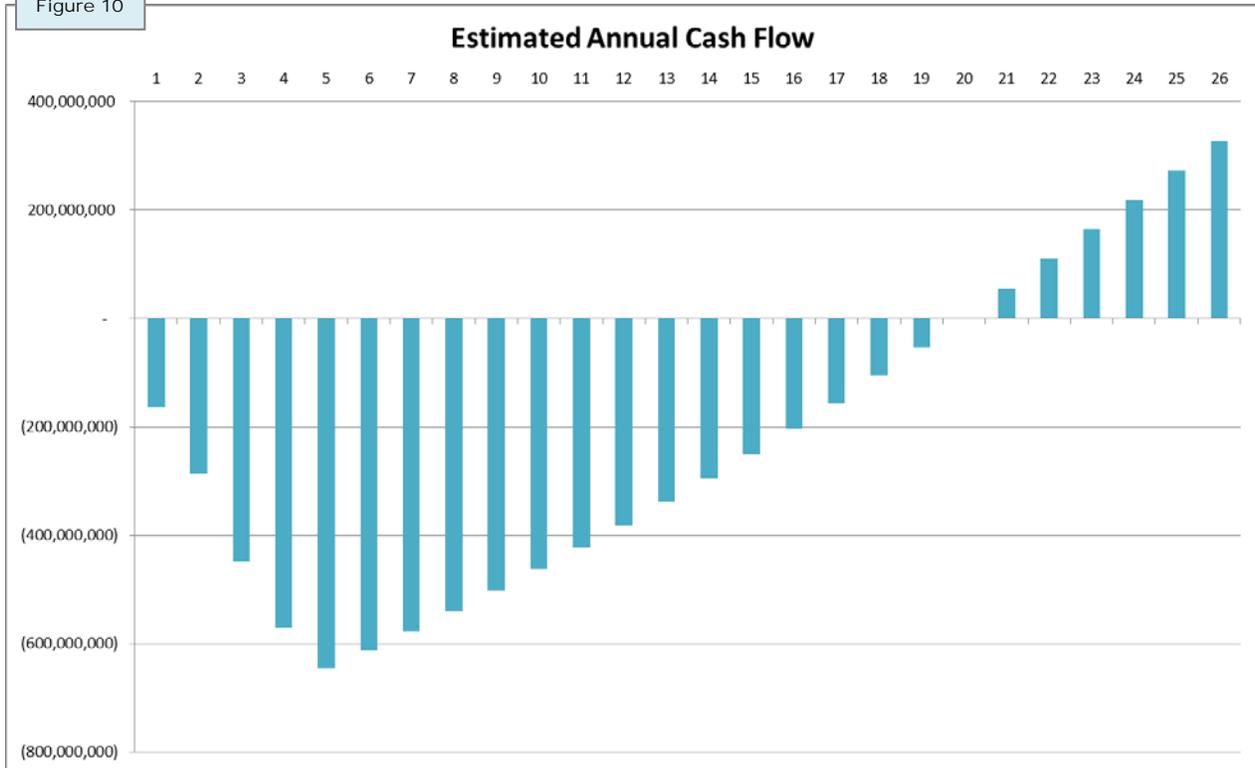
Statewide Community College and Public University Estimate					
Public University: IBHE Non-Subsidized Instructional Cost (\$9,749) Subtract One-Half of EFC for Third and Fourth Quintile Fifth Quintile Excluded					
Community College: Mean Weighted Tuition and Fees (\$3,626) Subtract One-Half of EFC for Third and Fourth Quintile Fifth Quintile Excluded					
Twenty Year Repayment					
Year	Incremental Cost	Total Cost	Incremental Revenue	Total Revenue	Incremental Difference
1	(537,100,000)	(537,100,000)	-	-	(537,100,000)
2	(849,700,000)	(1,386,800,000)	6,100,000	6,100,000	(843,600,000)
3	(1,014,400,000)	(2,401,200,000)	19,500,000	25,600,000	(988,800,000)
4	(1,141,000,000)	(3,542,200,000)	21,500,000	47,100,000	(1,093,900,000)
5	(1,233,200,000)	(4,775,400,000)	39,400,000	86,500,000	(1,146,700,000)
6	(1,233,200,000)	(6,008,600,000)	60,000,000	146,500,000	(1,086,700,000)
7	(1,233,200,000)	(7,241,800,000)	63,300,000	209,800,000	(1,023,400,000)
8	(1,233,200,000)	(8,475,000,000)	65,100,000	274,900,000	(958,300,000)
9	(1,233,200,000)	(9,708,200,000)	67,100,000	342,000,000	(891,200,000)
10	(1,233,200,000)	(10,941,400,000)	69,000,000	411,000,000	(822,200,000)
11	(1,233,200,000)	(12,174,600,000)	71,100,000	482,100,000	(751,100,000)
12	(1,233,200,000)	(13,407,800,000)	73,100,000	555,200,000	(678,000,000)
13	(1,233,200,000)	(14,641,000,000)	75,300,000	630,500,000	(602,700,000)
14	(1,233,200,000)	(15,874,200,000)	77,500,000	708,000,000	(525,200,000)
15	(1,233,200,000)	(17,107,400,000)	79,800,000	787,800,000	(445,400,000)
16	(1,233,200,000)	(18,340,600,000)	82,100,000	869,900,000	(363,300,000)
17	(1,233,200,000)	(19,573,800,000)	86,900,000	956,800,000	(276,400,000)
18	(1,233,200,000)	(20,807,000,000)	89,500,000	1,046,300,000	(186,900,000)
19	(1,233,200,000)	(22,040,200,000)	92,100,000	1,138,400,000	(94,800,000)
20	(1,233,200,000)	(23,273,400,000)	94,800,000	1,233,200,000	-
21	(1,233,200,000)	(24,506,600,000)	97,600,000	1,330,800,000	97,600,000
22	(1,233,200,000)	(25,739,800,000)	97,600,000	1,428,400,000	195,200,000
23	(1,233,200,000)	(26,973,000,000)	97,600,000	1,526,000,000	292,800,000
24	(1,233,200,000)	(28,206,200,000)	97,600,000	1,623,600,000	390,400,000
25	(1,233,200,000)	(29,439,400,000)	97,600,000	1,721,200,000	488,000,000
26	(1,233,200,000)	(30,672,600,000)	97,600,000	1,818,800,000	585,600,000

The programs can be evaluated by sector. A PIF program just for students at public universities could have a payback period similar to Table 6 and Figure 10 below. In this scenario the maximum annual state contribution would be around \$700,000,000. Again, the program would run at a deficit for 20 years.

Table 6

Public University					
IBHE Non-Subsidized Instructional Cost (\$9,749) Subtract One-Half of EFC for Third and Fourth Quintile Fifth Quintile Excluded					
Year	Incremental Cost	Total Cost	Incremental Revenue	Total Revenue	Incremental Difference
1	(163,000,000)	(163,000,000)	-	-	(163,000,000)
2	(287,500,000)	(450,500,000)	700,000	700,000	(286,800,000)
3	(452,300,000)	(902,800,000)	2,900,000	3,600,000	(448,700,000)
4	(578,900,000)	(1,481,700,000)	3,700,000	7,300,000	(571,600,000)
5	(671,100,000)	(2,152,800,000)	19,700,000	27,000,000	(644,100,000)
6	(671,100,000)	(2,823,900,000)	33,300,000	60,300,000	(610,800,000)
7	(671,100,000)	(3,495,000,000)	35,400,000	95,700,000	(575,400,000)
8	(671,100,000)	(4,166,100,000)	36,400,000	132,100,000	(539,000,000)
9	(671,100,000)	(4,837,200,000)	37,500,000	169,600,000	(501,500,000)
10	(671,100,000)	(5,508,300,000)	38,600,000	208,200,000	(462,900,000)
11	(671,100,000)	(6,179,400,000)	39,800,000	248,000,000	(423,100,000)
12	(671,100,000)	(6,850,500,000)	41,000,000	289,000,000	(382,100,000)
13	(671,100,000)	(7,521,600,000)	42,200,000	331,200,000	(339,900,000)
14	(671,100,000)	(8,192,700,000)	43,400,000	374,600,000	(296,500,000)
15	(671,100,000)	(8,863,800,000)	44,700,000	419,300,000	(251,800,000)
16	(671,100,000)	(9,534,900,000)	46,100,000	465,400,000	(205,700,000)
17	(671,100,000)	(10,206,000,000)	49,200,000	514,600,000	(156,500,000)
18	(671,100,000)	(10,877,100,000)	50,700,000	565,300,000	(105,800,000)
19	(671,100,000)	(11,548,200,000)	52,200,000	617,500,000	(53,600,000)
20	(671,100,000)	(12,219,300,000)	53,700,000	671,200,000	100,000
21	(671,100,000)	(12,890,400,000)	55,300,000	726,500,000	55,400,000
22	(671,100,000)	(13,561,500,000)	55,300,000	781,800,000	110,700,000
23	(671,100,000)	(14,232,600,000)	55,300,000	837,100,000	166,000,000
24	(671,100,000)	(14,903,700,000)	55,300,000	892,400,000	221,300,000
25	(671,100,000)	(15,574,800,000)	55,300,000	947,700,000	276,600,000
26	(671,100,000)	(16,245,900,000)	55,300,000	1,003,000,000	331,900,000

Figure 10

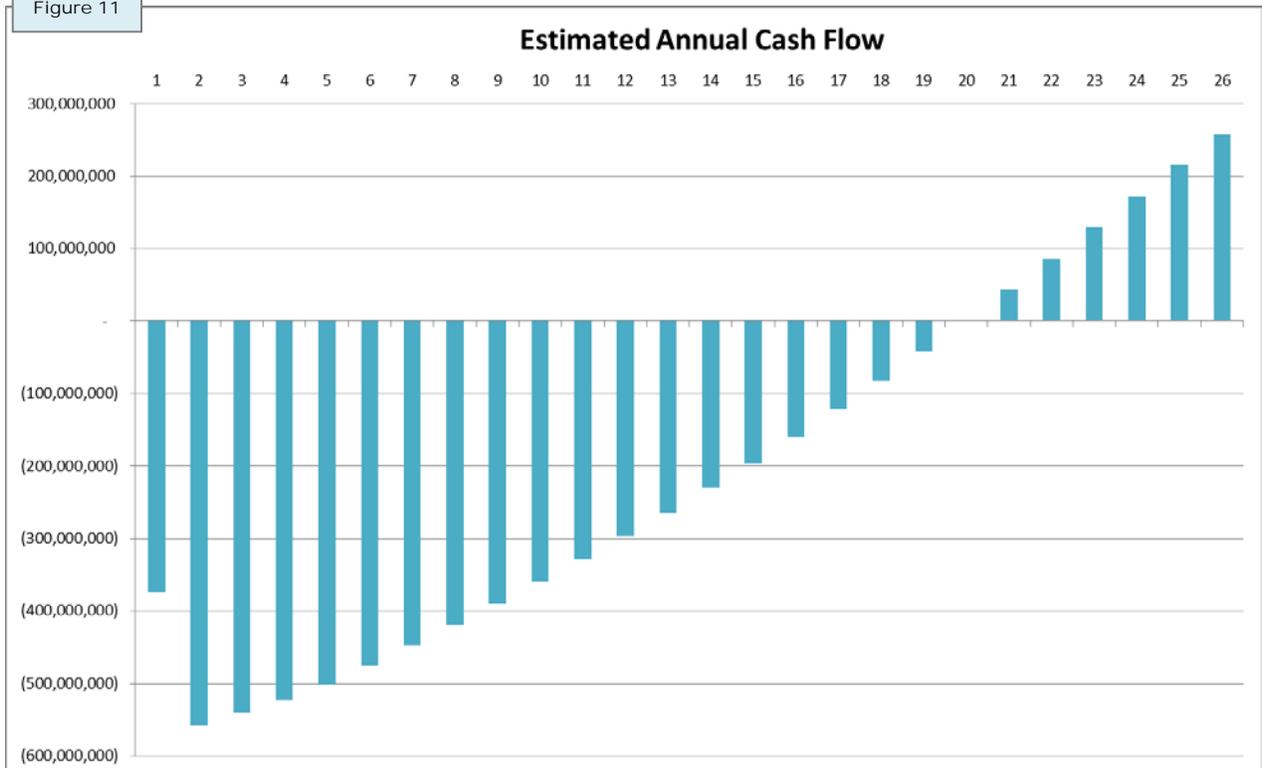


A community college PIF would also require a substantial upfront state contribution. Table 7 and Figure 11 show the net contributions for 26 years. By the fifth year the state net contribution would exceed \$550,000,000. While the costs are lower for community college students, the drop out rate is higher and the salaries overall are lower making expected returns to the state investment considerably less than for the public university program.

Table 7

Community College					
Mean Weighted Tuition and Fees (\$3,626) Subtract One-Half of EFC for Third and Fourth Quintile Fifth Quintile Excluded					
Year	Incremental Cost	Total Cost	Incremental Revenue	Total Revenue	Incremental Difference
1	(374,100,000)	(374,100,000)	-	-	(374,100,000)
2	(562,100,000)	(936,200,000)	5,200,000	5,200,000	(556,900,000)
3	(562,100,000)	(1,498,300,000)	16,100,000	21,300,000	(540,800,000)
4	(562,100,000)	(2,060,400,000)	17,200,000	38,500,000	(523,600,000)
5	(562,100,000)	(2,622,500,000)	21,100,000	59,600,000	(502,500,000)
6	(562,100,000)	(3,184,600,000)	26,000,000	85,600,000	(476,500,000)
7	(562,100,000)	(3,746,700,000)	27,600,000	113,200,000	(448,900,000)
8	(562,100,000)	(4,308,800,000)	28,400,000	141,600,000	(420,500,000)
9	(562,100,000)	(4,870,900,000)	29,200,000	170,800,000	(391,300,000)
10	(562,100,000)	(5,433,000,000)	30,100,000	200,900,000	(361,200,000)
11	(562,100,000)	(5,995,100,000)	30,900,000	231,800,000	(330,300,000)
12	(562,100,000)	(6,557,200,000)	31,800,000	263,600,000	(298,500,000)
13	(562,100,000)	(7,119,300,000)	32,800,000	296,400,000	(265,700,000)
14	(562,100,000)	(7,681,400,000)	33,700,000	330,100,000	(232,000,000)
15	(562,100,000)	(8,243,500,000)	34,700,000	364,800,000	(197,300,000)
16	(562,100,000)	(8,805,600,000)	35,700,000	400,500,000	(161,600,000)
17	(562,100,000)	(9,367,700,000)	38,700,000	439,200,000	(122,900,000)
18	(562,100,000)	(9,929,800,000)	39,800,000	479,000,000	(83,100,000)
19	(562,100,000)	(10,491,900,000)	41,000,000	520,000,000	(42,100,000)
20	(562,100,000)	(11,054,000,000)	42,200,000	562,200,000	100,000
21	(562,100,000)	(11,616,100,000)	43,400,000	605,600,000	43,500,000
22	(562,100,000)	(12,178,200,000)	43,400,000	649,000,000	86,900,000
23	(562,100,000)	(12,740,300,000)	43,400,000	692,400,000	130,300,000
24	(562,100,000)	(13,302,400,000)	43,400,000	735,800,000	173,700,000
25	(562,100,000)	(13,864,500,000)	43,400,000	779,200,000	217,100,000
26	(562,100,000)	(14,426,600,000)	43,400,000	822,600,000	260,500,000

Figure 11



What students wind up paying would depend on what percentage of their hours they PIF, their degree (or if they completed) and their income upon graduation. Some students would pay more and some would pay less than the actual tuition and fees. In these scenarios, under the income assumptions that were made, the state would not always recover its investment in students who do not complete. Starting salaries, even if grown out at rate that is greater than has been seen during the past decade, are too low for the state to recoup all the dollars spent on students who attend a public university but do not complete. Table 8 illustrates the differences. A student who drops out after one year at a public university, will pay back 1% of her income for 20 years. She is paying for 25 hours of classes that initially cost \$7,184. At the conclusion of 20 years, she will have paid back 85.8% of the cost. This is based on a starting salary of \$20,771 that is expected to grow at 2.83% per year.

Table 8		Statewide Community College and Public University Estimate							
		Public University: IBHE Non-Subsidized Instructional Cost (\$9,749) Subtract One-Half of EFC for Third and Fourth Quintile Fifth Quintile Excluded				Community College: Mean Weighted Tuition and Fees (\$3,626) Subtract One-Half of EFC for Third and Fourth Quintile Fifth Quintile Excluded			
		Twenty Year Repayment							
	1 YR Drop Out at Pub U	2 YR Drop Out at Pub U	3 YR Drop Out at Pub U	4 YR Drop Out at Pub U	1 YR Drop Out at CC	2 YR Drop Out at CC	4 YR Drop Out at CC/Pub U		
Starting Income	\$20,771	\$20,771	\$20,771	\$20,771	\$20,771	\$20,771	\$20,771	\$20,771	\$20,771
Income Growth Factor	2.83%	2.83%	2.83%	2.83%	2.83%	2.83%	2.83%	2.83%	2.83%
Tuition and Fees Deferred	(7,184)	(16,165)	(25,145)	(34,126)	(3,338)	(6,676)	(21,240)		
Cost Repaid through PIF	6,167	13,382	22,446	30,624	3,397	7,347	24,404		
Difference	(1,017)	(2,783)	(2,700)	(3,502)	59	670	3,164		
Percent Paid Back	85.8%	82.8%	89.3%	89.7%	101.8%	110.0%	114.9%		
Hours Assumed PIFed	25	57	88	120	25	57	107		
Income Percent PIFed	1.0%	2.3%	3.6%	4.9%	0.6%	1.3%	3.3%		
	4 Year BA at Pub U	5 Year BA at Pub U	4 Year BA at CC/Pub U	5 Year BA at CC/Pub U	1 Year Cert at CC	2 Year Cert at CC	2 Year AA at CC		
Starting Income	\$37,989	\$37,989	\$37,989	\$37,989	\$23,079	\$23,079	\$27,925		
Income Growth Factor	3.05%	3.05%	3.05%	3.05%	2.83%	2.83%	2.94%		
Tuition and Fees Deferred	(34,126)	(42,657)	(23,739)	(32,271)	(3,338)	(6,676)	(6,676)		
Cost Repaid through PIF	52,541	67,762	41,103	52,388	3,555	8,115	9,984		
Difference	18,415	25,105	17,364	20,117	217	1,438	3,307		
Percent Paid Back	154.0%	158.9%	173.1%	162.3%	106.5%	121.5%	149.5%		
Hours Assumed PIFed	120	150	120	133	25	57	60		
Income Percent PIFed	4.9%	6.1%	3.8%	4.4%	0.6%	1.3%	1.3%		

Although these models are very sensitive to the assumptions made, it is clear that PIF programs are expensive programs, and these costs would be in addition to the contribution the state already makes through direct appropriations and the grant programs. Under the assumptions selected for the examples used in this report, students at public universities who do not complete pay the smallest percentage of costs incurred. This is a result of the income stream that was assumed for these students. Some of them will do better and there are probably modeling distinctions that can be made between expected incomes of students who drop out after a year at a community college compared to a student who completes three years at a public university but fails to finish. The data used for this report was not detailed enough to make those types of distinctions.

An interesting comparison can be made among students who complete a bachelor's degree in four different ways and then take jobs at the average wage for a bachelor's degree. Students who complete a bachelor's degree by attending a community college for two years and then transferring

to a public university for two years repay the least amount of money, \$41,103. This is roughly \$12,000 less than the repayment that would be made for a four-year degree obtained by attending a four-year institution exclusively. However, this advantage is completely lost if the student's 2+2 program takes five years instead of four. The most expensive way to acquire a bachelor's degree in this model is by taking five years at a public university. Students choosing this option pay 65% more for their education than those utilizing a 2+2 program and obtain a credential in four-years. The difference are due entirely to different PIF percentages.

In the baseline section of this report, it was demonstrated that some middle income families, particularly those whose children graduate and enter jobs with modest starting salaries, pay more for college than other families. Under a Pay It Forward program, these families do better.

Table 9				
Baseline Bachelor's Degrees	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile
w/o PIF - total cost	\$ 127,315	\$ 127,880	\$ 133,501	\$ 120,035
w/o PIF - parent and student cost	\$ 58,975	\$ 64,900	\$ 84,757	\$ 84,095
w/PIF - total cost	\$ 111,637	\$ 110,424	\$ 110,961	\$ 111,343
w/PIF - parent and student cost	\$ 58,009	\$ 62,156	\$ 76,929	\$ 90,115

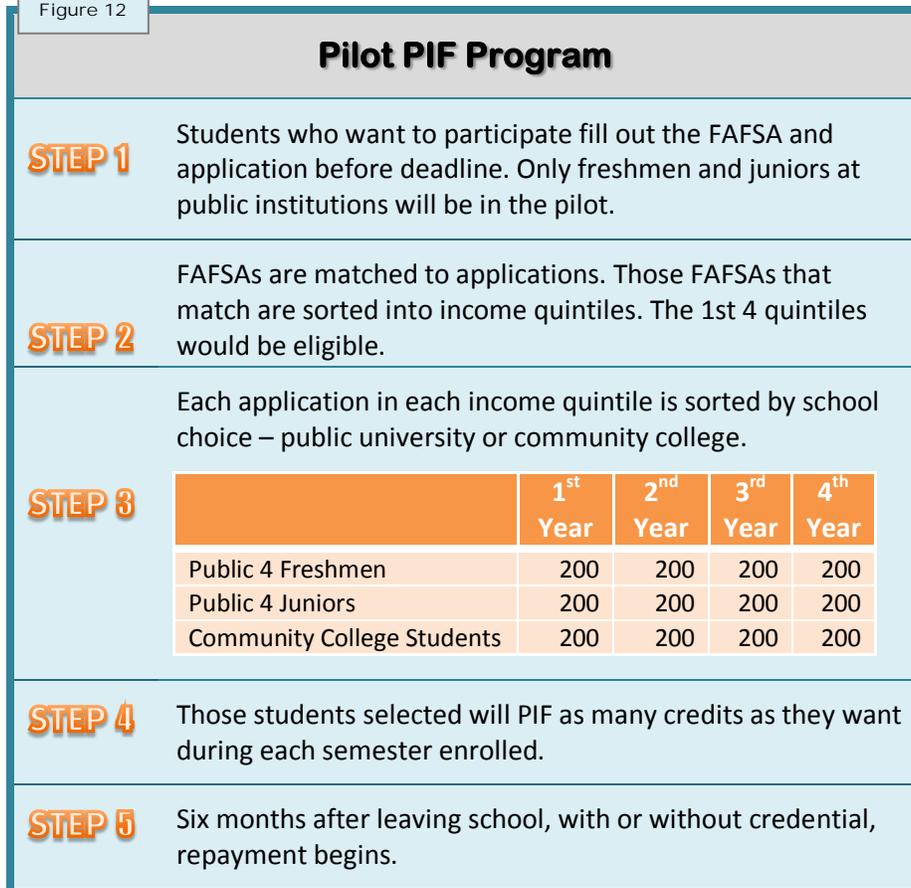
As can be seen in Table 9, a student from a middle income family entering the workforce at a starting salary about \$38,000 would have a parent and student cost of about \$85,000 under the conventional system with student loans. This high cost can be attributed to receiving little or no state or federal aid to offset the initial cost of college and then having to accept an extended repayment plan to pay off the student loans because the student's income is relatively low but not low enough to qualify for loan forgiveness. Under Pay It Forward, these students do a bit better. For the lowest two income quintiles, who would not have to borrow, the costs are about the same. For the student in the fourth income quintile, the cost is a little higher. This is due, in part, to assumptions made about the amount of the family EFC actually available to pay for school. Families have more discretionary income at this income level; if more was diverted to paying for the student's college costs up front, the percentage on the PIF would be reduced and the total paid would fall as well.

It appears to be possible to design a PIF Program that can begin to recoup its costs in 20 years. Because Illinois public university tuition and fees are higher than average, the percentage of incomes that need to be PIFed are a little higher than what other states are proposing. A PIF that appears workable for Illinois would have a student completing a 120 hour bachelor's degree at a public university PIFing about 4.9% of her income for 20 years. A student completing a 60 hour associate's degree would have a 20-year PIF of about 1.3%.

## A Pilot Program for Pay It Forward in Illinois

There are many uncertainties surrounding a Pay It Forward Program that are difficult to bound with existing information levels. Data such as program participation rates, both the number of students who would choose to participate in a PIF program and the level of participation for those that do participate (number of hours PIFed), are important data elements that are uncertain. Implementation issues such as identifying and tracking students and finding the best repayment mechanisms need to be worked out. Establishing and maintaining an efficient collection procedure is essential for a successful PIF program. While there are currently operating PIF programs that could be used as a guide, the existing PIF-type programs do not mimic a state sponsored program exactly. If the legislature decides that it is interested in pursuing the PIF program option, the best way to acquire data and work out procedural and collection issues is by running a pilot program. If the pilot is carefully structured, the data on participation rates will be obtained and there will be ample opportunity to make process adjustments to fine-tune the administration of the program. A carefully selected sample of participants may also allow us to collect some data on whether PIF programs affect student and school behavior such as different major selection or improved year to year retention.

Figure 12



This report outlines a PIF Pilot program that is large enough for sound data collection, even allowing for analysis at some subgroup levels such as by school selectivity, or student family income quintile. It would be offered to students at both public universities and community colleges, although the programs could be separated and one or the other could be offered.

The pilot program would be voluntary but it would only be open to freshmen and juniors (students with more than 60 but less than 86 credit hours) attending public universities and freshmen at community colleges. Students wishing to apply for the program would apply at the same time as they fill out their FAFSAs. FAFSA completion would be mandatory for program participation. All the application would consist of is a check-off indicating that they wanted to participate in the program and selecting the public school they are attending. Even the school selection could be optional – the first choice school selection on the FAFSA could be used instead.

The program would have a cut-off date. After that date all FAFSAs that matched the eligible applicants would be sorted into income quintiles based on the AGI reported on the form. Students in the first four income quintiles would be eligible to participate.

The applicants in each income quintile would be further sorted into freshmen at public universities, juniors at public universities, and freshmen at community colleges. Each of the four eligible income quintiles would therefore have three groups of students making twelve groups in all. Two hundred students would be randomly selected from each group, making a pilot program of 2,400 students. A waiting list would also be pulled to fill in for students who decided not to participate.

These 2,400 students would be permitted to PIF as many credit hours as they want at their respective institutions. The school would be paid by the state to compensate for tuition and fee revenues lost through student deferral. Each student would sign a PIF agreement and have a PIF account that would be maintained and tracked by the state as they progress. After a student leaves school or graduates, there would be a six month grace period before repayment would begin. Students would be required to maintain contact with the state and to set up a payment plan in order to procure transcripts from the institution they attended.

By the second year of the pilot, some repayments would be coming in from students who dropped out of school and students who completed one year certificates. These funds would be placed in a trust fund and used to defer the cost of future years. After the second year, some of the juniors would have graduated with bachelor's degrees and some of the community college students would have acquired their associate's degrees. Income and repayment assumption testing would begin at this point. By the end of six years, most of the procedural details should be worked out and the state would have a better idea of the demand for a PIF program and the level of participation that could be expected. If a carefully matched control group was constructed at the same time the PIF participants were identified, it might be possible to see if PIF had an impact on persistence and time-to-degree.

The estimated cost of a pilot program is detailed in Table 10. The Costs Deferred section of the table uses the same costs and retention fractions as the PIF program analysis (Appendix VII) and assumes that students are essentially going full-time (27 hours per year). The program costs the most in the initial year when all 2400 students are enrolled. After the first year, enrollment is projected to fall by the estimated number of dropouts added to the number who complete one-year certificates. After two years, enrollment is further reduced by dropouts, those completing two-year certificates and associates degrees, and those juniors who are completing bachelor's degrees. Of the \$44 million in program costs for this pilot, all but about \$8 million is incurred in the first three years.

Table 10

<b>COSTS DEFERRED BY STUDENTS</b>				
Year	Public U Freshmen	Public U Juniors	CC Freshmen	Total
1	\$ 7,019,280	\$ 7,019,280	\$ 2,320,640	\$ 16,359,200
2	\$ 5,358,739	\$ 5,393,587	\$ 1,166,680	\$ 11,919,007
3	\$ 2,935,105	\$ 3,928,799	\$ 749,709	\$ 7,613,613
4	\$ 2,255,323	\$ 1,964,400	\$ 576,105	\$ 4,795,828
5	\$ 1,642,824	\$ -	\$ 419,615	\$ 2,062,438
6	\$ 821,412	\$ -	\$ 209,807	\$ 1,031,219
	\$ 20,032,683	\$ 18,306,066	\$ 5,442,556	\$ 43,781,306
<b>REVENUE FROM REPAYMENT TO STATE TRUST FUND</b>				
Year	Public U Freshmen	Public U Juniors	CC Freshmen	Total
1	\$ -	\$ -	\$ -	\$ -
2	\$ 24,040	\$ 7,325	\$ 51,565	\$ 82,930
3	\$ 101,954	\$ 36,586	\$ 152,932	\$ 291,472
4	\$ 138,526	\$ 516,345	\$ 157,520	\$ 812,391
5	\$ 718,558	\$ 1,140,042	\$ 162,246	\$ 2,020,846
6	\$ 1,247,659	\$ 1,174,243	\$ 167,113	\$ 2,589,016
	\$ 2,230,738	\$ 2,874,541	\$ 691,376	\$ 5,796,655
<b>NET COSTS TO STATE</b>				
Year	Public U Freshmen	Public U Juniors	CC Freshmen	Total
1	\$ 7,019,280	\$ 7,019,280	\$ 2,320,640	\$ 16,359,200
2	\$ 5,334,699	\$ 5,386,262	\$ 1,115,116	\$ 11,836,077
3	\$ 2,833,151	\$ 3,892,214	\$ 596,777	\$ 7,322,141
4	\$ 2,116,798	\$ 1,448,055	\$ 418,585	\$ 3,983,438
5	\$ 924,266	\$ (1,140,042)	\$ 257,369	\$ 41,593
6	\$ (426,247)	\$ (1,174,243)	\$ 42,694	\$ (1,557,796)
	\$ 17,801,946	\$ 15,431,525	\$ 4,751,181	\$ 37,984,652

Some revenue is collected beginning in year two. Since the early revenue stream is coming from students with two-year degrees or less or from dropouts, both the PIF percentages and the income subject to the PIF percentage are very small and that is reflected in the size of the revenue stream. The costs will ultimately be recouped from the participants after 20 years, and by year six of the pilot program, the net revenues are positive.

In addition to the cost of the pilot program itself, there are administrative and start-up costs. Since the program infrastructure, including participation agreements, setting up a higher education trust fund, more fully costing out the program to develop PIF percentages, establishing participant tracking and payment protocols would have to be designed prior to even a pilot program implementation, administrative costs per participant will be very high for the pilot. Actuarial, tax and legal assistance would be needed, and there would be data to collect and evaluate, forms and procedures to develop and staff training for program maintenance and participant tracking. All of these processes would need to be tested during the pilot phase and all would have to be fully implemented and possibly revised as the program proceeds. A reporting and payment structure will also have to be developed with the schools where PIFs will be used. Start-up costs are very difficult to determine because the amount of professional contracted time is unknown but a conservative estimate of \$4 million in start-up costs (including legal, tax professional and actuarial costs) and for program administration may need to be appropriated for the year *prior* to implementation; \$2 million for the second year (the first year of implementation where collection activities would have to be developed) and at least \$500,000 annually for years three through seven for program maintenance and evaluation.<sup>97</sup>

The pilot program was designed to allow the state to check assumptions such as participation rates, drop-out rates, and default rates, and work out implementation issues. The small scale and the size of the program and the types of participants selected are designed to facilitate those goals. However, the pilot could be divided into three even smaller pilots (public university freshmen, public university juniors and community college freshmen) and one or more could be offered separately, reducing the initial cost. Unfortunately, the administration cost would remain about the same.

While the pilot program is designed to defer costs for students for six years, with the initial preparation lead time required and the twenty year repayment period, the actual pilot would last for 27 or 28 years and costs would be incurred in all of them. A pilot program needs to be implemented prior to a full scale implementation of a PIF program to test assumptions and work out program administration procedures, however, even a PIF *pilot* program is a big commitment of time and funds. The fundamental problem with a full-scale PIF program, finding a source of financing for the early years of the program, should be substantially solved before implementing the pilot, even though providing the funding for a full-scale program could be several years away. Without doing so, the state would risk having a pilot program that would be no more than a very expensive, decades-long experiment with a significant demand on limited staff and resources – albeit an interesting one.

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<sup>97</sup> Many of these services would have to be bid out which makes it very difficult to estimate the actual start-up costs. Staff time at agencies involved would run around \$75/hour average including benefits. Staff would be needed to develop computer programs, forms, initiation, tracking and collection procedures, much of which has not been done before. After program is up and running, system maintenance, on-going program evaluation and auditing, and the college payment, student tracking, and collection activities would have to continue. For comparison, ISAC currently spends about \$6 million on similar account collection activities on federal loans. A program such as Pay It Forward could increase those costs by half.

## Summary and Conclusion

This report provides some background and context for the proliferating Pay It Forward, Pay It Back (PIF) legislation seen across the country. It describes the mechanics of a PIF program, outlines the conditions that would need to be met for a program to be viable, and identifies the issues and questions that require resolution before a program could be implemented.

It is important to remember that no state PIF program has been implemented, even as a pilot program. Similar programs have been implemented in other countries but they have some important differences from the state programs being proposed. First, these countries were moving from a completely taxpayer-funded system to a “shared-responsibility” model where students paid for some of the costs. The implementation of a Pay It Forward type of program therefore represented a cost *savings* to those countries, not additional costs, eliminating the biggest burden that most state programs, including Illinois, would face. Second, these countries can utilize nationwide entities such as their tax officers for participant tracking and collection activities. States, at this point, have only state resources at their disposal. The ability to track the addresses of and collect money from PIF participants at the state level is not assured and the costs per participant to do so would likely be higher than for nationwide programs.

While PIF programs have generated much interest by legislators as evidenced by the volume of legislative activity, there are many in the higher education community who oppose PIF programs. While some critics offer up logistical problems and student to student cost shifting as reasons for their dislike, the most prevalent and fundamental reason for the considerable opposition to these programs is the belief that they will mask declining state support for higher education and hasten the march toward the complete privatization of higher education. While state divestiture of higher education does not necessarily follow from implementing a PIF program, any workable PIF program would have to provide safeguards to address these concerns. Furthermore, PIF programs will never be economically feasible if college costs increase faster than incomes. The state needs to be able to assert control over college costs or otherwise ensure cost containment to a degree not previously exhibited.

Assuming those safeguards are in place, and an adequate funding source could be found, a PIF program was modeled using a consistent set of assumptions to illustrate how it might work in Illinois. The analysis indicates that it is possible in Illinois to design a PIF program with a 20-year break even point (the point at which the state no longer has to make *additional* contributions) and keep the PIF percentages on income under 5%. A pilot program would be needed to test the accuracy of some of the assumptions concerning school and student behavior that need to be made when forecasting participation in this type of program. A pilot would also establish the workability of participant tracking and collection processes developed for the program.

The simulations indicate that students seem to benefit from a PIF program and it could offer some relief to students from middle-class families who receive little need-based aid and now rely on expensive PLUS loans and private loans to fill the gap between the costs incurred and federal

Stafford Loan limits. Students from families with lower incomes who receive considerable state and federal need-based grant aid could possibly bypass the federal student loan program entirely and rely only on the PIF program.

In addition to the significant problem of financing a PIF program, there is an additional reason to wait before implementing a PIF program. The two federal bills described in the report, H.R. 3959, The “Pay It Forward” Guaranteed College Affordability Act and H.R. 4436, “Investing in Student Success Act of 2014”, would provide both legal and financial support to the states looking to develop PIF programs. H.R. 3959 would offer states an opportunity to apply for competitive grants to carry out Pay It Forward pilot program that could help offset the costs of developing a program. The implementation of H.R. 4436 would provide a national legal framework for ISAs that are often the financial instruments in a PIF program and could minimize the legal work that would be required to develop a state PIF program. The bill would also clarify the federal tax treatments of ISAs and define how PIFs would affect a student’s eligibility for financial aid. Having more clarity and support of federal law is critical to be able to implement a successful state PIF program.