BALANCING THE FUNDING EQUATION:

A **SIMPLIFIED** COLLEGE FINANCIAL SUPPORT MODEL

CAPELLA UNIVERSITY

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In the United States, making higher education widely available has been an important project over the past two centuries.

Currently higher education is available to more people who previously had been excluded by law, tradition, or circumstance. Now we have the responsibility to provide education to accommodate the jobs our economy will require. Education is vital to economic growth and development. As the face of the contemporary student in America evolves, our nation's financial support model must also evolve.

To get there, we must understand the hurdles within our higher-education funding system.

First, rising costs and unhealthy levels of student debt threaten access to education. Second, too much complexity in the current federal student aid programs, too little usable data with which to judge progress or improve outcomes, and a lack of transparency surrounding higher education cost and the return on that investment restricts availability. Finally, the current system does not adequately foster innovation to maximize new models for delivering high-quality, affordable, workforce-relevant education. Although not the focus of this paper, much can be gained by creating a regulatory framework that fully unlocks the potential of direct assessment, competency-based education, and other emerging forms of innovation in higher education.

The system originally designed to help students pay for college has become too complex. It has failed to keep pace with the changing face of the contemporary student. Similar to the problem in our private health insurance system—real costs are obscured within a system of confusing insurance premiums, co-pays, and claims payments that are not clear to the consumer—educational funding has few incentives to control costs. Our government continues to struggle to improve outcomes by tackling problems after they arise, instead of designing a system that helps meet educational goals for students, citizens, and the world.

Simplicity and transparency should be the core of a strategy for funding higher education.

Students should understand their options and what they can expect when they leave college. Grants should make up a significant proportion of an aid package for low-income students, and low-interest loans should have no hidden fees. State support of higher education must be increased. Finally, all parties involved in the educational success of our nation's students need to participate in funding their education. The model we propose avoids symptom-chasing by fostering simplicity, innovation in delivery, and shared responsibility among students, schools, employers, and government.

Transparency + Visibility | College Planning Tool

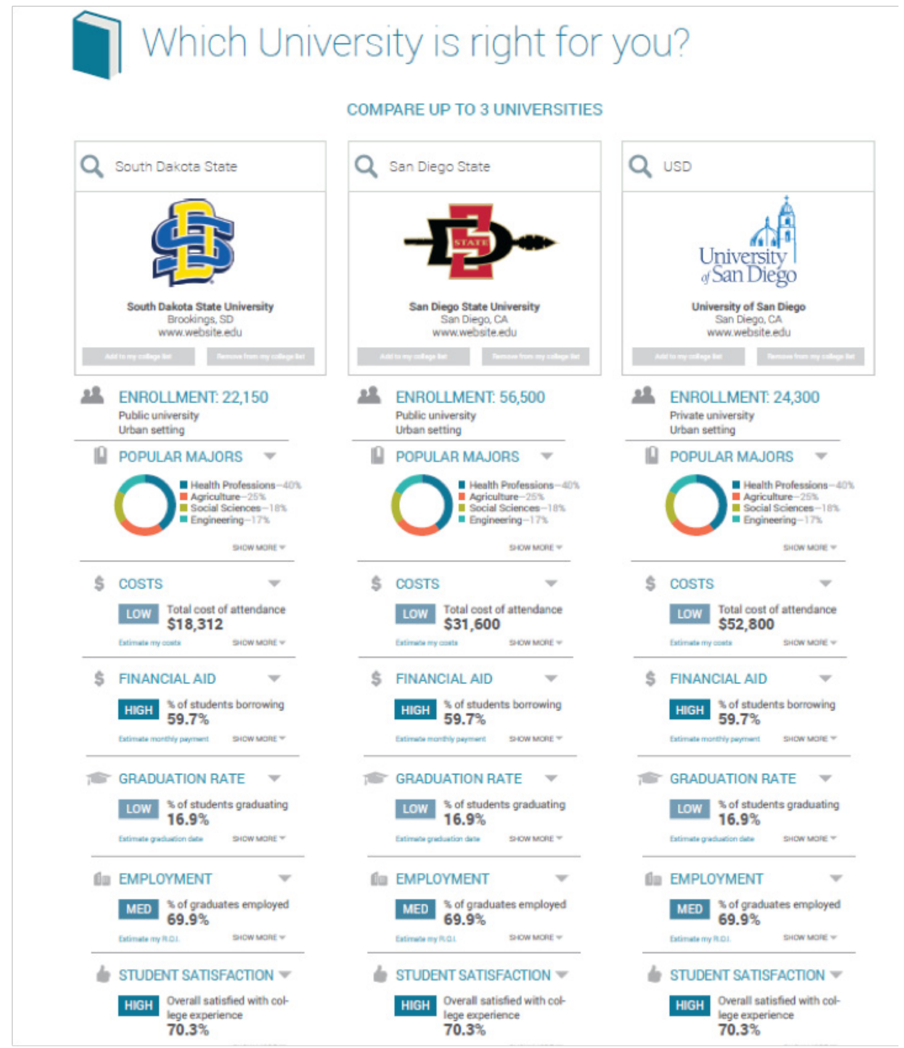
Research has shown that making high school students aware of college choices, including financial implications, is critical to enrolling students in institutions of higher education.

Initiatives that provide high school students with information about the college selection process are pivotal in helping them understand both their choices and the financial realities of those choices. But among low-income students, such information should be available sooner. High school students not only need information earlier about the college application process, funding options, and pathways to earn college credit, but they could also benefit from a system that could identify Pell Grant eligibility earlier (pre-high school) and develop funding accounts. Students could use those dollars as seed money when they enroll in college, allowing them to know the balance of this funding stream as they explore their options. Finally, moving to a federal financial aid application process that utilizes prior-prior year data to determine aid eligibility will give college-bound students access to their financial aid award much earlier.

Understanding their choices in making college decisions ensures that prospective students know their options, as well as outcomes that similar students see at particular institutions. This level of information sharing is only possible through enhancements to tools such as the College Scorecard and College Navigator. However, these tools are only as good as the data available to them. To ensure we can share outcomes that represent all students at all institutions, creating a student unit record system is vital in order to provide information to students and ensure that taxpayer money is well-spent and aptly directed. With data on all students, federal college selection tools can provide accurate, pertinent information to students at all stages of the inquiry process, ensuring that they understand not only their options, but what they can expect from their school of choice.

Tools like the College Scorecard should work for all students—adult, returning, working professionals, students with military commitments, and more. In addition, information for students pursuing nontraditional methods of education, including online or self-paced options should be included. Finally, **federal college comparison tools should be streamlined and data should be consistent across all comparison tools to reduce confusion among students and their families.**

A more robust college scorecard can
reduce confusion among students.



Transparency + Visibility | Financial planning

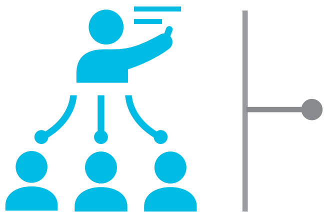
Students across all degree levels should clearly understand their remaining financial aid eligibility, or how that translates to continued progress within their program. Institutions of higher education have a responsibility to provide this information to students regularly. This responsibility extends beyond required entrance and exit counseling, or a net price calculator. Instead, schools should work with students to build a funding plan that overlays course enrollment to ensure students have no reason to stall in their education due to financial barriers.

Nationally better data must be made available to taxpayers, legislators, and other interested parties. Federal data that are comparable across institutions is the key to policy that improves outcomes, and safeguards federal funds. Outcomes measurement and analysis must take into account the differences among institutions. It is not possible to create a one-size-fits-all policy for institutions serving different populations of students, which is why the data must be comparable.

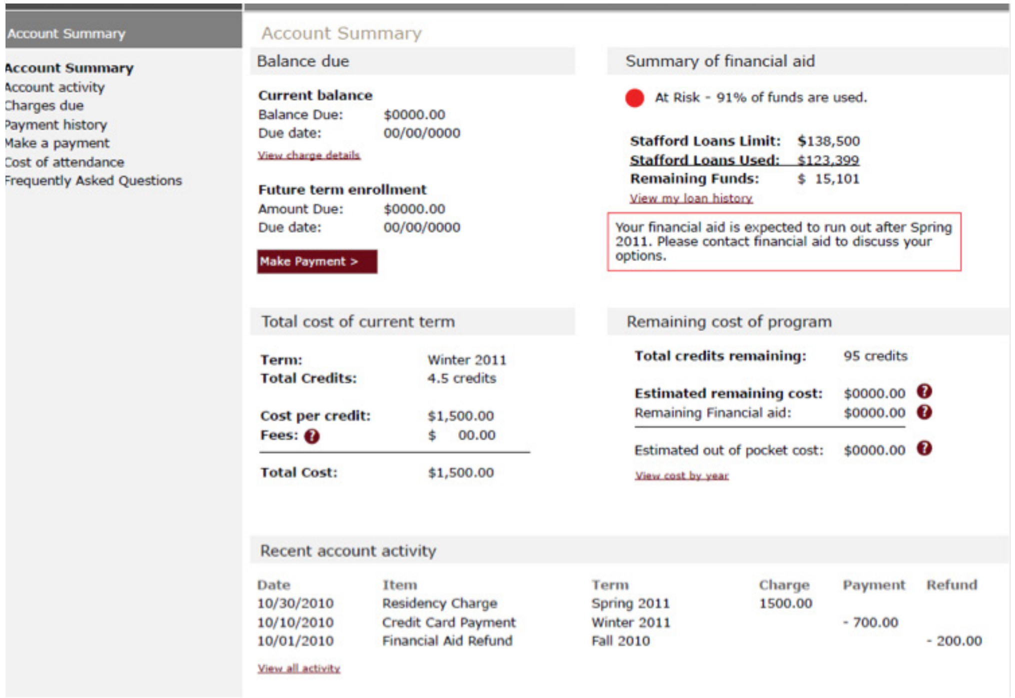
Specifically, the United Sates needs better data on the following:

1. Comparable, risk-adjusted graduation rates
2. Cost to students
3. Cost to taxpayers and to produce graduates
4. Employment outcomes

Passing the bipartisan Student Right to Know Before You Go Bill, sponsored by Senator Ron Wyden (D-OR) and Representative Duncan Hunter (R-CA), would be a critical first step in creating disclosure that will produce these data. The bill would create a nationwide database designed to inform stakeholders about post-graduation annual earnings; rates of remedial enrollment, credit accumulation, and graduation; average cost (both before and after financial aid) of the program, and average debt accumulated; and the effects of remedial education and financial aid on credential attainment. Collecting, understanding, and disseminating these data provide insight for prospective and current students, taxpayers, legislators, and institutions alike.



To enroll, retain, and ultimately, graduate students successfully, it is **imperative to provide communication early and often regarding financial planning**, and its impact on enrollment status.



Funding Programs

Grants

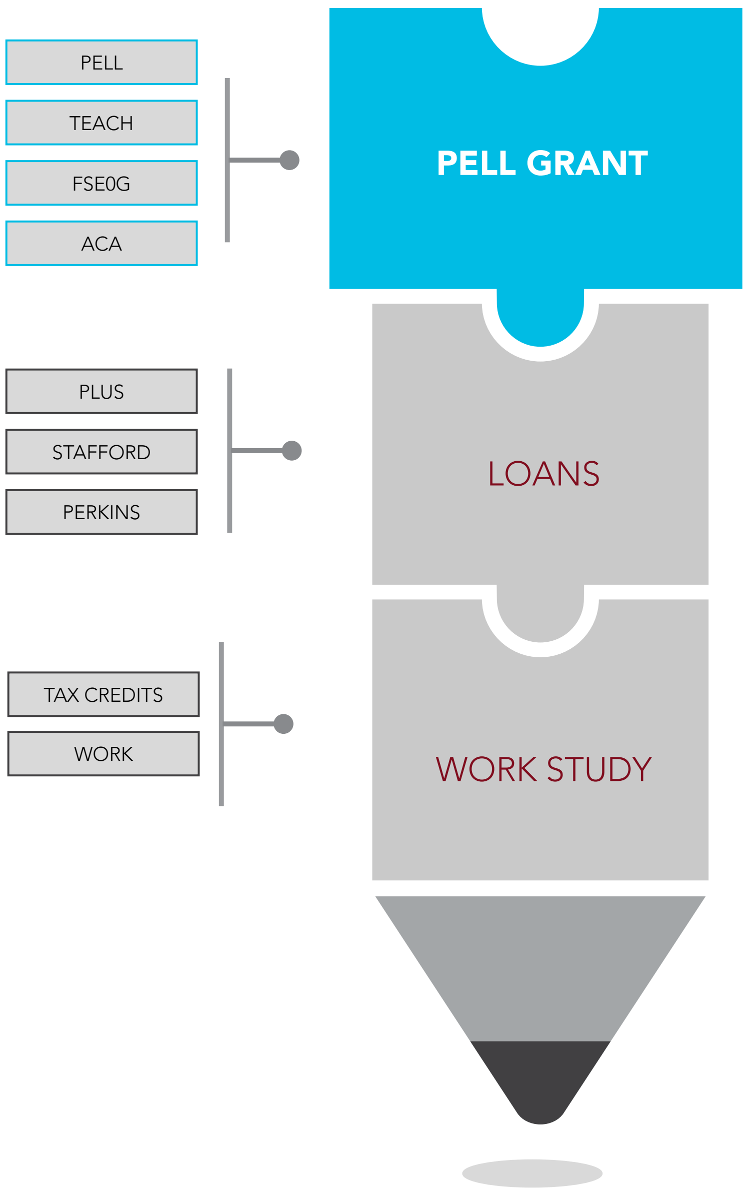
In our proposal, the Pell Grant serves as the flagship program for need-based funding. Building and ensuring access to it for needy families will help ensure stability as the funding system evolves, which will reinforce that income should not be a barrier to attending college. Funding for the Pell Grant program must be available in perpetuity for families to be confident it will be available for their children. These funds also should be available without significant barriers.

We propose three tiers of Pell Grant funding, with the first tier being full funding for students who meet the current auto-zero test. Pell Grants in the two additional tiers would be allocated using a simplified collection system (FAFSA) that focuses on income. It will use IRS data where possible and request minimal additional data around household size and wealth. We support using prior-prior year data to facilitate early planning and simplicity as well as a lesser-regulated iteration of year-round Pell to support students who accelerate in their programs. To further decrease operational complexity, we propose replacing the current lifetime limits (LEU process) with a student-level satisfactory academic progress (SAP) measurement that will allow continued Pell Grant funding if a student maintains lifetime SAP.

Loans

Responsible borrowing of and access to loans is a key feature of our educational funding model. Student loans, if done well, allow students to receive education and promote their ability to select a college while simultaneously defraying some of the cost to taxpayers. The creation of a loan program is not intended to reduce the allocation of grant funding by states, the federal government, or institutions, and controls must be in place to reign in net price inflation.

REINVENTING EDUCATION FUNDING



Funding Programs

To both **simplify and add accountability** to the federal student lending structure, we support:

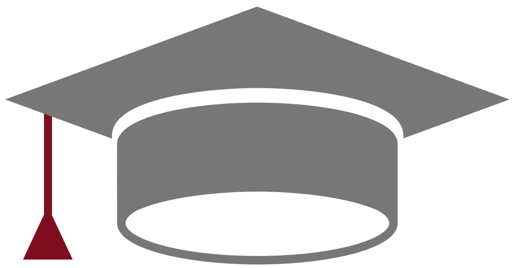
- Federal loan financing under the framework of one loan program with one interest rate and one income-based repayment plan. This program would have a lifetime limit that allows students to obtain an education at their own pace. Lifetime limits should be determined by credential level, and high enough to ensure higher education at every degree level is accessible to even the lowest-income students. Finally, these would be simple, predictable, and most important, visible. This flexibility will be meaningful for today's nontraditional students and allowing them to accelerate (or decelerate) as their life plan dictates.

- Federal loan counseling should be mandatory for all borrowers prior to an initial loan disbursement. Counseling should be mandated when students advance to a higher credential level. Students who do not meet lifetime SAP expectations are not pacing their attainment of knowledge with their borrowing and should be required to complete annual loan counseling.

- Schools should have administrative authority to limit student borrowing in excess of educational costs.

- Eliminating origination fees (or other fees) that confuse students regarding amounts they borrowed. For the system to achieve transparency, a tenet of the loan program must be: what you borrow is what you owe once you enter repayment.

- Student-level SAP—enabled by a student unit record system—should be explored to ensure accountability for progress and eliminate the risk of perpetual borrowing that doesn't lead to a credential.



ONE

Loan

Interest rate

Repayment plan

Loan Repayment

The current federal student loan repayment system is comprised of too many options. Borrowers have several income-based repayment plans for which they may qualify, and multiple loans, servicers, and forgiveness programs. Instead, a single income-based repayment plan, accessible to all borrowers, who opted into automatically for students that become significantly delinquent, should be applied. Functionality should allow loan payments to be drawn directly from employers, which would offer opportunities for scalability to this program. This model would also allow employers the opportunity to provide matching dollars to help accelerate the repayment of an employee's student loans.

In addition to revamping the federal student loan repayment system, current loan forgiveness programs also must be simplified. The ideal program will have the primary means of forgiveness triggered by a 20-year income-based repayment plan. Loan forgiveness targeting employees in high-needs fields or specific sectors would be incorporated into the income-based repayment program, potentially through a reduction of total years of payments required before balances are forgiven. Alignment with an income-based repayment plan has two profound benefits. First, it uses the same system to track payments as the income-based plan. Verifying borrower eligibility based on employment in a high-need field would be streamlined. Second, borrowers in high-need fields or targeted higher-income sectors will have a smaller portion of their loan forgiven than lower-income earners who need the benefit.

Work Study

A federally funded work-study program offers increased potential for employment. According to a recent paper, work-study students were 5.2 percentage points more likely to earn their bachelor's degree within six years, and 3.7 percentage points more likely to be employed after six years than other working students*. Work study provides experience relevant to a student's career and reduces reliance on student loans. Although the program currently serves many students, enhancements can increase the impact and scope of the program.

Significant changes are needed to the allocation formula currently in place in the Federal Work Study program. Potential solutions are presented in the paper "A Federal Work Study Reform Agenda to Better Serve Low-Income Students." In this paper, Young Invicibles calls for, "Implementing a new distribution formula focused on enrolling, serving, and graduating Pell recipients." We agree with the proposal to eliminate the base guarantee, creating equity and ensuring that low-income students who benefit from the program have increased access to work-study funds.

To the extent possible, we advocate for an increase in the federal investment in the work-study program. As we expand this program, it should also be noted that work study is one of the only sources of non-loan funds for graduate student. Ensuring graduate students continued access to these funds will encourage lower-income students to continue their education beyond the bachelor's level. This investment in graduate education is imperative to ensure talent is available for skilled jobs required in our increasingly complex economy.

Finally, we acknowledge the program's history of giving back to the community. In this area we support making the new experimental site initiative that promotes the concept of near-peer counseling permanent. In addition, a new experiment or demonstration project could be offered to allow colleges to coordinate outreach and community-based programs within their local campus communities without partnering with external organizations. This option would expand opportunities for rural schools and distance-education providers to participate in the Federal Work Study program.

* Should Student Employment Be Subsidized? Conditional Counterfactuals and the Outcomes of Work-Study Participation (A CAPSEE Working Paper) By: Judith Scott-Clayton and Veronica Minaya | September 2014

Funding Consideration

Although we believe our program proposals are fiscally reasonable, we recognize that changing the educational funding system or increasing investment at a federal level will be at a cost to our nation's taxpayers.

Therefore, we recommend the following measures to offset some costs associated with our proposed system:

- **Sunset the American Opportunity Tax Credit and Lifetime Learning Credit.** A recent study has shown that nearly a quarter of these tax breaks go to families making more than $100,000 a year, and that doesn't include the 1.5 million tax filers who were eligible for the benefits but failed to claim them*. If the tax code is to incentivize education, funds should be focused on supporting early investment in a Pell Grant savings account that augments students' need-based funding once they attend college. The current backend tax credit system does not effectively change behavior. These funds could provide more impact if used to invest in education for low-income families and encourages low-income students to realize that college is possible at an early age.

- **Sunset the Federal Perkins Loan Program, Federal TEACH Grant, and Federal Supplemental Educational Opportunity Grant program.** Redirect these funds into the programs we have outlined.

- **Discontinue administrative cost allowance payments made under the campus-based and Pell Grant programs.** Simplifying the federal aid programs will result in operational savings for both the federal government and institutions, making these payments less essential.

* http://www.clasp.org/resources-and-publications/publication-1/Nov2013RADD_TaxAid.pdf

Stakeholders + Accountability

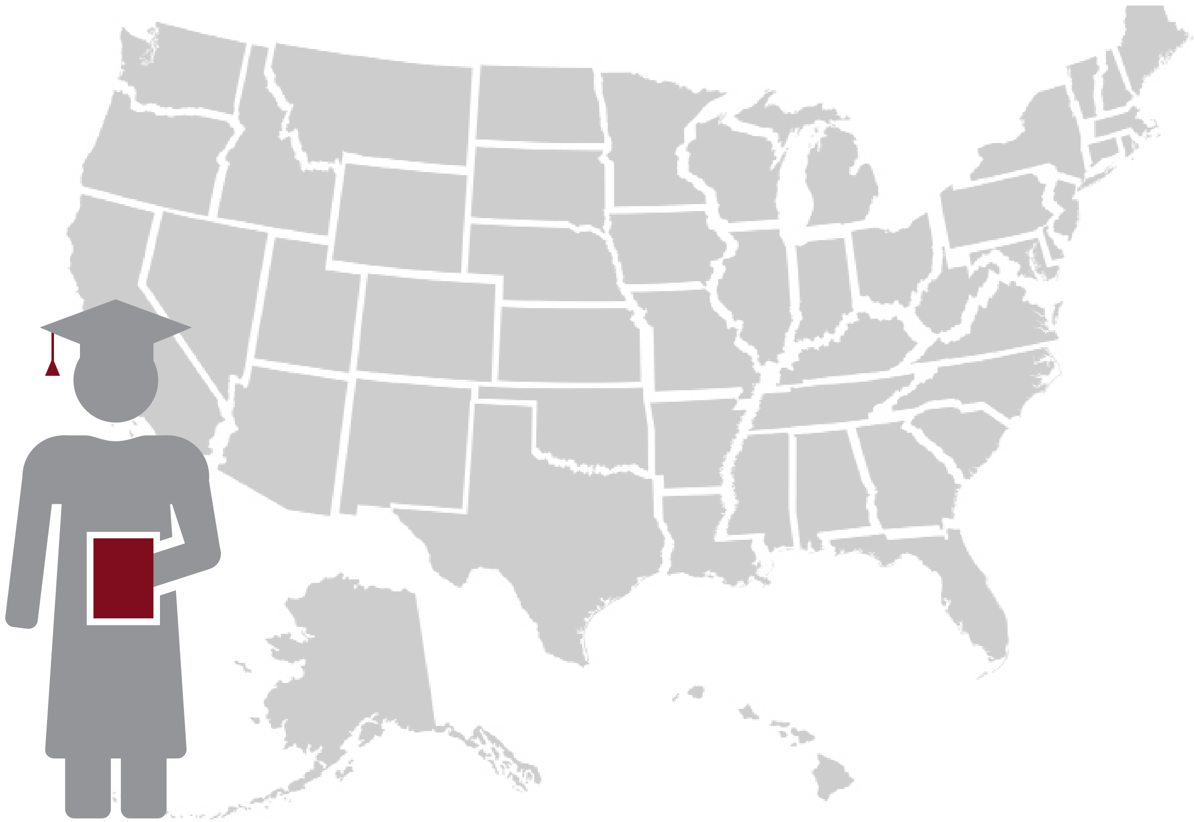
Ultimately, streamlining, improving, and expanding the funding options for students can only be possible through collaboration and coordination among a variety of stakeholders. The existing federal funding system cannot and should not bear the entire responsibility of making education financially feasible. Doing so requires a shift in how we approach higher education funding. A sustainable model requires input from the federal government, states, employers, institutions, and students.

States

Federal education funds provided to institutions and states, outside of the above mentioned programs, should be allocated with some weight given to net price. Tying federal fund allocation to net price is an effective way of rewarding states and institutions that successfully control costs or provide significant sources of grant aid. Using net price in addition to other accountability and transparency measures will allow for controls that ensure that the federal government, states, institutions, and students play a part in a balanced and sustainable funding system.

Funding of higher education has declined steadily in many states over the past decade. As a result, students at public schools must fund a larger portion of their education without state support. A recent report from the Center for American Progress indicates that between 2008 and 2012, state funding as a percentage of total revenue decreased from 29.1 percent to 22.3 percent. All states decreased their share of revenue from state governments. To this end, all states need to dedicate consistent funding to public institutions to ensure that students are not unexpectedly adversely harmed through large tuition increases.

In addition, states need information about outcomes at public institutions that receive funding, and a way to hold those schools accountable for the outcomes of their students. State funding formulas that take into account fiscal trends (limiting tuition increases, lowering costs) and consistent metrics will help ensure funds are put to good use. These will also show taxpayers which institutions are fiscally efficient and responsible. For example, Michigan's two- and four-year institutions receive funding



based on, among other things, limiting annual tuition increases in addition to degree completions. The ideal state performance-based funding formula will focus on a risk-adjusted completion rate and fiscal responsibility, and involve enough funding to have an impact. Finally, this rubric and its annual results will be transparent to taxpayers.

Stakeholders + Accountability

Federal Risk Sharing

In order to ensure that tax dollars are protected and federal funding is used to promote access and completion at higher education institutions, a model of risk sharing should be used that creates accountability for schools. Risk sharing currently exists in a limited form within the Title IV program through the Perkins Loan program, but it is time to expand and connect it to the outcomes of our Title IV-granting institutions.

Traditional approaches to risk-sharing proposals have included tying the institutional cohort default rate to some degree of federal loan school buy-in, as proposed in the Protect Student Borrowers Act of 2013. Ultimately the idea of connecting risk sharing to defaults is flawed because the Department of Education does not take on a great risk through granting Federal Stafford Loans to students. In fact, the Department of Education recovers more than 80 percent of principal and interest owed on a defaulted loan*, which leaves little room for accountability in federal loan risk sharing.

Instead, Capella University proposes an institutional buy-in, based on the percentage of students eligible for Pell Grants who stop out without graduating or returning to school within two years. A school's financial responsibility would be determined by dividing the percentage of undergraduate students who stop out without returning to school within two years (or graduating) by the percentage of undergraduate students who received Pell funds at the institution. This Pell Grant Index number multiplied by the institution's annual Pell Grant allocation would equal the amount the institution is required to match.

Students receive more than $30 billion through the Pell Grant program annually, and taxpayers have little to no information about what this money accomplishes. It is a true risk because Pell Grant funds given to students who ultimately stop or fail to complete a credential cannot be recovered. Our approach not only provides information about Pell Grant graduation rates across schools, but also goes a step further to require a financial buy-in from schools where low-income students are not graduating. Such a methodology also accounts for schools serving high-risk populations, while ensuring that an accountability measure is in place for Title IV-granting schools.

Central to establishing a risk-sharing model is the universal collection of student data, which can be used to, among other things, create good policy and provide transparency and accountability at the postsecondary level. With whatever format it takes, a solid risk-sharing model will need to account for those schools that serve higher-risk populations, and provide risk-adjusted metrics that reflect such populations.

* http://www2.ed.gov/about/overview/budget/budget15/justifications/s-loansoverview.pdf S-31

Our recommendation: Institutional buy-in

Pell Grant Index number **X** The institution's annual Pell Grant allocation **=** **The amount the institution is required to match.**

Let's keep the conversation going

As both America's investment in higher education and need for more skilled workers increases it is imperative that the nation's financial support model evolves to meet the needs of contemporary students. In order to enable greater access to higher education and encourage completion, the funding system must be recreated to ensure simplicity and transparency, rational and sustainable funding methods, measurable outcomes, an easily navigable student loan repayment system, and a collaborative funding model that involves all higher education stakeholders.

Piecemeal changes to America's funding system no longer meet the needs of students or the nation's workforce. Instead, a broader overhaul of the model must occur to increase access to education, decrease student borrowing, and ensure that as a nation, we equip students with the skills they need to fill critical roles in their communities.