June 8, 2015

Testimony on Pay It Forward (HB 2662)

House Revenue Committee

Financial Aid Advisors across the state see few benefits and many problems with the Pay it Forward Program. Although proponents claim it is not a student loan program, in fact it is a student loan, and can be very costly to the students who choose to participate in it.

By definition (a thing that is borrowed, especially a sum of money that is expected to be paid back with interest) is a "loan". The Truth in Lending Act would apply, and requires disclosure of the "finance charge" and the "annual percentage rate" and certain other costs and terms of credit. These provisions enable consumers to compare the prices of credit from different sources.

A student's "contributions" to the fund upon graduation are not limited to the amount of tuition assistance received plus interest, but rather are based on a set percentage of the student's annual earnings. Because annual earnings (and not principal and interest) are used to calibrate the student's repayment obligation over a lengthy period of time – up to 20 years – students are exposed to a significant probability of paying what amounts to extremely high interest rates.

Many students and their families are reticent to take on obligations of repayment even when it is clear what the size and terms of the repayments are prior to agreeing to the obligation. The level of uncertainty and lack of transparency of the Pay It Forward program, could serve to discourage students from attending college. Students may avoid paying a set tax or fee on an unknown future income, a tax that bears no relation to the actual amount of the funds that were loaned.

How Pay It Forward Would Work for a Typical OSU Student

Oregon State University's financial aid administrators provide prospective and continuing students with options for paying for college, including comparisons of different loan options, using actual OSU student data. Based on the income profile for an average OSU graduate, and the average loan indebtedness upon graduation, OSU will advise students to decline participation in Pay It Forward and take advantage of more equitable, affordable options.

For example:

The average Direct Loan debt upon graduation for an OSU student is currently $24,591. If this amount is repaid over ten years at 4.66 percent interest, a student will face a

monthly payment of approximately $260. Total cost to the student over the term of the loan would be $30,500. The same student, earning an extremely conservative average salary of $80,000 participating in the "Pay It Forward Program" with the same debt load, would face a total cost of $64,000, well over double the amount of a conventional student loan. The high cost is due two factors: First it is based on the student's income, and second the term of repayment is 20 years. The annual interest rate on the Direct Loan would have to triple – to 15 percent – in order to make the Pay It Forward Program attractive to a student earning $80,000.

The lowest average starting salary for an OSU graduate is around $38,000. At a steady $38,000 annual income for the 20 year repayment period in "Pay It Forward", the total cost of the $24,591 loan would be $30,500, comparable to the total cost of the Direct Loan program. The comparability, however, is solely based on the assumption that the student's salary never increases over a 20 year work history.

A "Pay It Forward" loan simply would never be an attractive alternative to OSU students when compared to conventional student loans.

Most concerning, "Pay It Forward" does not offer an opportunity to accelerate payments, buy out of the program, or consolidate with other student debt as provided under the conventional student loan programs. While locking into the program is necessary to make the program work financially, it creates impacts for individual students once they graduate and their incomes begin to grow.

The bill does not address the impact if students use BOTH "Pay It Forward" and the federal loan system, a very distinct possibility because less than 40% of the cost of attendance for Oregon resident students is attributed to tuition and fees. (These are the only costs that are covered by Pay It Forward.). Students will be required to manage multiple accounts and payments, which data has shown contributes to higher default rates. One of the justifications for moving to a single, Federal Direct Student Loan program was to avoid multiple student loan providers, and thus to reduce the instance of default.

Impact of Federal Aid and Reauthorization

Early discussions between the National Association of Student Financial Aid Administrators and the Direct Student Loan Coalition Board, (made up of seasoned leaders in the higher education student aid profession), with officials at the US Education Department are focused on expansion of the student loan income contingent repayment options and have moved away from the "pay it forward" concept. Expansion of the income contingent repayment options are aimed at providing additional mechanisms to repay student loans, streamline loan payments, avoid missed payments, avoid defaults and collections costs.

Funding Required for Administration of a New Program

The administration of the "Pay It Forward Program" will be complex and expensive. Instead of creating another loan program – Oregon's financial aid directors believe the funds would be much better spent on increasing the appropriations to the Oregon Opportunity Grant Program which has a proven record of increasing college participation and completion rates of those most in need. Increased grant funding lowers their need to borrow, whereas Pay It Forward increases the burden of repayment with fewer options for retiring the obligation.