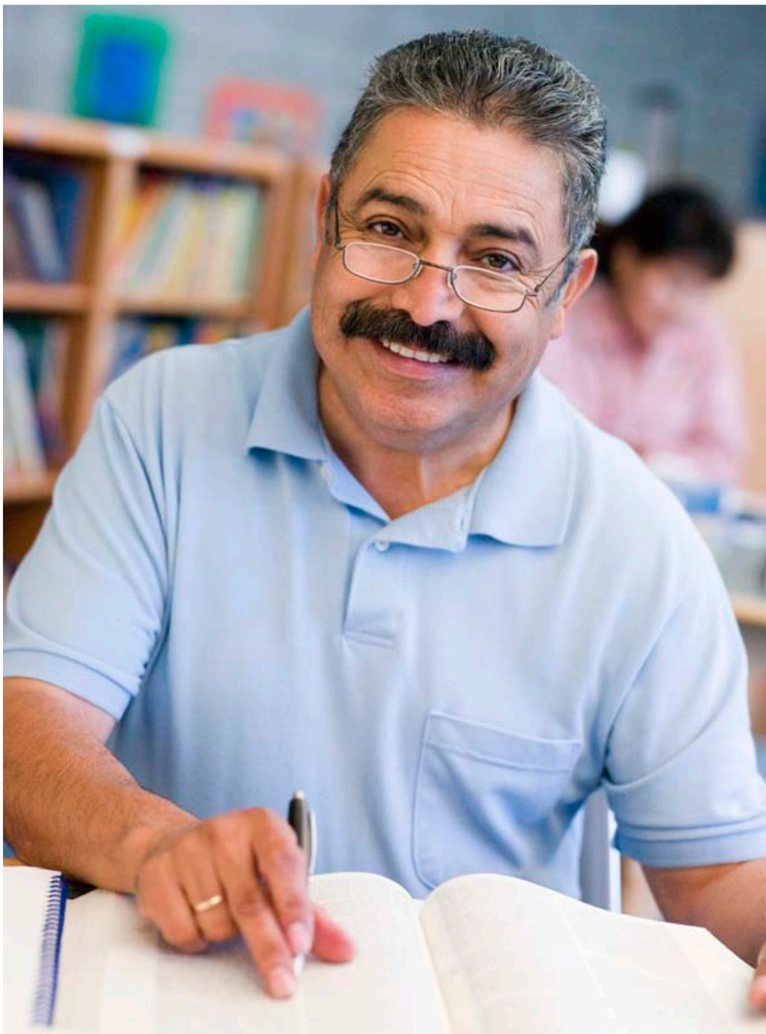
SkillUp WASHINGTON

express advantage

2014

College Completion Fund Report



This paper was commissioned by SkillUp Washington and Express Credit Union/ Express Advantage, and was supported through grants from Northwest Area Foundation and the Turnstone Family Fund. The paper was prepared by Rich Nafziger, an economist and faculty member at Seattle University's Institute for Public Service.

Introduction

This paper was commissioned by SkillUp Washington and Express Credit Union/ Express Advantage, and was supported through grants from Northwest Area Foundation and the Turnstone Family Fund. The paper was prepared by Rich Nafziger, an economist and faculty member at Seattle University's Institute for Public Service.

SkillUp Washington is a workforce funders collaborative that supports employers and working families in the Seattle-King County area by: 1) working with employers to align workforce training with industry needs; 2) investing in targeted and innovative programs that help low-income adults receive postsecondary credentials; and 3) supporting programs that help workers get trained and advance in their fields.

SkillUp is about building hope, innovation, and leadership: Hope for thousands of people trapped in poverty because they lack the skills and access to an education that could provide them with the tools to change their lives for the better; innovation for employers who are in need of a skilled pool of workers ready to take on high demand jobs; and leadership through collaboration and new ways of thinking that create a positive economic impact within our communities.

Express Credit Union's mission is to provide affordable financial services to low- and moderate-income people; and in doing so, help them build assets and achieve financial stability. Express Credit Union is a community based and member-owned not-for-profit financial institution serving the Puget Sound community since 1934. Express offers checking and savings accounts, loans and other products that deliver great value and exceptional service to our members, Express Advantage is a related nonprofit whose mission is to provide the outreach, education and supports that Express members need to be successful.

February 2014

College Completion Fund

Executive Summary

A combination of rising costs, cuts in financial aid, and inflexible aid eligibility rules are making it ever more difficult for adult students to complete education and job training programs that could boost their wages and improve their productivity. And adults – many of whom have families to support – are a growing share of community and technical college students. Today, far too many of them leave post-secondary education programs without completing them because they simply cannot afford to do so. The result is low wages for them and a growing skills gap for Washington employers.

Some of these students lack sufficient financing because they are deterred by the overwhelming complexity of the financial aid system. Others find themselves in colleges that do not offer federal loans, or are deterred because they do not know about available aid, or because aid application deadlines result in delayed or deferred enrollment.

These adults will comprise the majority of the American workforce for the next quarter century, and their levels of skill and knowledge will be key determinants of our state's prosperity. Thus, finding new ways to help them enroll, persist and succeed in post-secondary education and training must be a high priority.

Research clearly shows that when these students work more than 10 or 15 hours per week, they are at much higher risk of dropping out, because the burden of full time work, family obligations and school simply cannot be sustained.

However, we know what helps students succeed. Overcoming financial barriers is paramount. Enrolling in a specific program of study with a clear path to a career is also critical. In addition, there is a growing body of research showing that students who receive consistent and effective financial coaching are able to complete their programs of study, make strategic use of financial aid and student loans, and repay these debts.

Therefore, this paper proposes to pilot a new loan program for adult students that will fill in the gaps left by current loan programs.   This loan program, which could be piloted at North Seattle Community College, and embedded in the college's Opportunity Center. Thus, students would benefit from best practices in ongoing financial counseling and coaching as well as social, employment and other services. Low-interest loans will be offered by Express Credit Union in amounts ranging from $500 to $10,000. Philanthropic organizations will provide funding for a guarantee fund and financial counseling. In the first year of the program, $250,000 would be available for lending, with a guarantee fund of $100,000.

Express already has an office at the entry to the Opportunity Center providing banking services to low-income clients. Coordination of the Express Office with financial, social, employment and education services provides a rare opportunity to design services around people rather than fitting people into services.

Express Credit Union is one of six certified Community Development Entities in Washington State. It is a member of the Federation of Community Development Credit Unions, whose mission is to serve low income and minority communities beyond the reach of banks and mainstream credit unions. These credit unions specialize in serving low wage earners, recent immigrants, the aged, and people with disabilities.

Loans will be targeted to lower income adults who are enrolled in a program of study that will lead to a higher-wage job, and who have already earned some college credits. Interest rates would be in the range of 2 percent to 4 percent, and the term for repayment would be limited to three to six years.

Performance measures for this program will include returns to the credit union, increased college program completions, improved employment outcomes, and improvement in students' ability to navigate education and employment systems and manage their personal finances.

This model, if successful, could be expanded to serve the growing number of adults who struggle to learn the skills they will need to earn decent wages and to contribute to the prosperity of our state.

1. Background

The rising cost of college and the complexity and inadequacy of financial aid programs put college out of reach for a majority of lower-income working adults. The price of tuition, books and fees is soaring, and financial aid is not keeping up with these rising costs.

Only families with income under roughly $40,000 per year are eligible for state and federal financial aid, and in the state of Washington, 30% of students who are eligible for the State Need Grant are not funded because of recent budget cuts. The largest source of direct financial aid, the federal Pell Grant, no longer covers a significant portion of the cost of college; it has fallen from nearly 75 percent of the cost to less than one third. Federal Stafford loans are available to most students, but there are still many who are ineligible. Stafford loans are capped, and interest rates are often high. Many colleges do not offer them at all. In addition, students are often so confused by the complex application process they do not apply.

A corollary problem is that many students have great difficulty figuring out how to finance their education, and, if they use student loans, even greater difficulty figuring out how to manage their debts. A growing body of research has shown that as education financing becomes more complex and more reliant on loans rather than grants, student success requires more intensive, ongoing and effective financial coaching.

These problems must be solved if we are to meet the needs of today's employers for skilled workers, and if we are to sustain our commitment to opportunity for all Americans who want to work hard and provide for their families. Today's working adults will be a majority of our work force over the next 25 years, and many adults simply do not have the skills to compete in the global economy. This has created a skills gap that threatens our state's competitiveness, and may result in businesses outsourcing work overseas to find skilled workers. We must find a way to leverage private, philanthropic and student resources to address this problem.

One solution is to provide low interest loans through Community Development Financial Institutions, and to pair these new loans with financial coaching. Financing is by far the number one barrier to both enrollment and completion. Borrowers have a much higher completion rate than non-borrowers when they do not have to work more than half time. The problem is that many lower-income working adults do not have access to credit, and default rates for student loans are already high. However, there are solutions to this dilemma. Research has identified factors that can reduce risk and promote success. These factors include enrolling in "pathways" programs that are easy to navigate and lead to a defined job in a high demand field; participation in financial and academic counseling; and completion of a defined number of college credits before borrowing. Our proposal is to provide loans to lower-income adults who meet these criteria. This will require establishing a loan program, providing academic and financial counseling and planning, and staffing to service this new program.

2. Recommendations

Research for this project included review of over 40 research papers on the topic, interviews with over a dozen experts in the field, and interviews with an equal number of business leaders. The consensus appears to be that the project is feasible if there is a guarantee fund that covers the level of risk, and underwriting criteria that ensures students are directed into programs with a high probability of success.

Clearly, federal Direct Student Loans are the primary source of capital for college loans. There is a huge risk pool, and loans do not need to be co-signed or subject to credit checks. Interest rates are set at 3.4% for low-income students, and 6.8% for all others, and the loans offer generous repayment options.

However, there is a need for a different type of lending program. A high percentage of students who get federal loans default. Students often drop out, and end up with huge debts they cannot pay back. A successful student loan program requires that loans be packaged with intensive student career and financial counseling, and coursework pathways that lead to a defined, high-demand, family wage job.

A new loan program is needed to fill gaps in the federal program. Students earning over roughly $40,000 per year are not eligible for the low-income 3.4% interest rate. Not all students are eligible for federal loans, many colleges do not offer them, and lending caps are often inadequate. Financial aid officers support the creation of a loan program that can serve students who are left out by current student financing programs.

Community Development Finance Institutions and Community Development Credit Unions are financial institutions that target banking services to communities and people that are unable to access private credit and lending services. These institutions have a great deal of expertise in working with lower-income families and people with no credit history. While these institutions offer payday, auto and often mortgage loans, they currently do not offer student loans. Express Credit Union in Seattle, Washington has specifically asked if they should expand to student loans.

This is a high-risk proposition. Most students in this target population do not have access to private credit. Students are able to access federal loans, but nearly one-fifth of community college students' default on student loans at some time during the life of the loan. Students who fit our target populations have even higher default rates in the range of 23% to 62%. This compares unfavorably with payday, auto and other loans targeted to the same population with defaults in the range of 1-6%. However, experts in the field indicate that if there were a guarantee fund to cover approximately 30% of total loan value, and adequate underwriting criteria, this new project would likely meet their financial standards.

We propose to start small and grow a new loan program over time, based on experience. The program would start with a guarantee fund of roughly 30%. Based on our research and interviews, there are four options to consider.

1) **The Direct Model**: Express Credit Union would offer loans directly to students. Express would utilize an underwriting checklist based on the factors that are associated with program completion and limit financial risk. Philanthropic organizations could provide funding for a guarantee fund as well as staff for financial and career counseling.
2) **The Opportunity Center Model:** Express would utilize its office at North Seattle Community College to offer loans on site. The Opportunity Center serves all low-income families with social, employment and college services, thus putting the loan program at the center of already established services. Philanthropic organizations would provide funding for a guarantee fund and financial counseling. Express would work with a team of agency and college program officers who would award loans to fill in gaps left by current programs.
3) **The State Model:** Credit unions, including Express, who are Community Development Financial Institutions certified by the U.S. Department of Treasury, would offer loans regulated by the State Department of Financial Institutions. The state would create a guarantee fund to start up the program and funding for staff. This could be accompanied by a tax credit for employers who assist students in paying back the loan.
4) **The Business Model:** Express would offer the loans to employees and potential employees in a particular business or industry. Businesses would assist students in paying back the loans and the state could provide a tax credit to match expenses.

Our recommendation is that we start with the Opportunity Center model (model 2). North Seattle Community College is eager to participate, and staff at the Opportunity Center believes that this type of program is key to serving all students.

The direct model would be the simplest and quickest to implement, but it doesn't incorporate the academic and career planning expertise that a college can offer. Furthermore, colleges would be better able to specifically define funding gaps and recommend specific pathway programs that lead to good jobs.

The state model could be combined with the Opportunity Center model to provide financing and staffing. However, both state and federal funds are in very short supply and passage would be difficult.

In my survey of a dozen businesses and associations, there was not a lot of interest in the business model. Due to the great recession, demand for skilled workers is down. However, a business component of the program could be added in particular industries.

3. Profile of the Product

Based on advice from community development finance professionals, we are looking at a loan product that could be defined by these specifications:

a) Express Credit Union would provide capital to students to invest in college programs.
   - ❖ Loans would be targeted to lower income adults who face substantial college cost gaps or students who are close to the line for financial aid eligibility.
   - ❖ Interest rates would be in the range of 2% to 4%.
   - ❖ Loans would be in the range of $500 To $10,000
   - ❖ Loans would be limited to a maximum of two years.
   - ❖ Terms for loan repayment would be limited to three to six years.

b) A foundation- or government-funded guarantee fund would be established to provide a reserve against loan losses. The fund would cover somewhere in the range of 30% of the loan value. As more experience is developed with the program, the size of the guarantee fund would increase more slowly than the volume of loans and the percentage guaranteed would decline.

c) Loan volume would expand over time:

Year one -	$250,000	$100,000 guarantee
Year two -	$500,000	$200,000
Year three -	$1,000,000	$200,000

d) Two distinct underwriting criteria would be utilized. Express Credit Union would utilize its current criteria for general loans for this population. In addition, criteria designed to address default risks would be designed to include;
   - ❖ Program of study
   - ❖ College Credits already attained
   - ❖ Financial, career and academic counseling

4. Performance Measures: How Do We Define Success?

We would establish specific performance measures based on the goals of the program:

a) The product must provide a return to the credit union.
   - ❖ The average per loan earnings to the credit union
   - ❖ The percentage annual loan loss
   - ❖ The proportion of students in default
   - ❖ The proportion of students in delinquent loan status

b) The product helps working adults complete college and get a good job with benefits.

- The proportion of borrowers who are still enrolled or have completed their college program
- The proportion of students who are employed more than three quarters after completion of their program
- The average wage of students once employed

c) The product aids students in navigating college, employment and personal finance
- The proportion of students who complete a student academic plan
- The proportion of students who are engaged in career planning and job search throughout the program and at its conclusion
- The proportion of students who file a FAFSA
- The proportion of students who develop a financial plan

Benchmarks would be created for each of these measures after the completion of additional research.

5. Student Demographics are Not What We Think They Are

We are targeting working adults for several reasons. First, they are already the majority of community college students. The profile of community college students in the minds of some policy-makers is a single student who has recently completed high school and is going to school full time. Nothing could be further from the truth. Community college students (and university students as well) are older, often with dependents, and going to school part time while they are working. Unfortunately, policy-makers have designed tuition and financial aid around the needs of single, recent high school graduates. The median age of Seattle Community Colleges students is almost 30. Almost a fifth are immigrants, over 30% have dependents, a quarter are working full time and well over half are working part time or more. A majority are students of color. For the entire post-secondary system in Washington State, almost 40% of the students are over the age of 30. Two-thirds of the students who entered college at age 25 or older are low income.[1] In Seattle, only 5% of community college students have entered directly from high school.

Demographics	Seattle Central	Seattle North	Seattle South	Seattle Vocational Institute	Washington State Community Colleges
Immigrants or refugees	18.5%	8.6%	9.3%	17.5%	8.4%
Single with Children	7.0%	7.0%	11%	27%	11%
Couples with Children	12%	23%	23%	9%	19%
Work Full time	18%	29%	29%	7%	17%
Work Part Time	26%	26%	20%	13%	26%
Median age	27	29	29	29	26
Over age 30					37%
Students of Color	55%	39%	52%	83%	36.3%
Source: Washington State Board for Community and Technical Colleges, Data Warehouse, 2011					

Clearly, the demographics of the student population trend every more heavily towards working adults. Moreover, these s workers will still be a majority of the workforce in 2038.[2] Our state's biggest skills gap problem is the lack of high-demand skills among these adults. If our goal is to succeed in global competition over the next decade, this is Investment is needed.

[1] Prince and Jenkins, April 2005, *Building Pathways to Success for Low-Skill Adult students*, CCRC Brief,

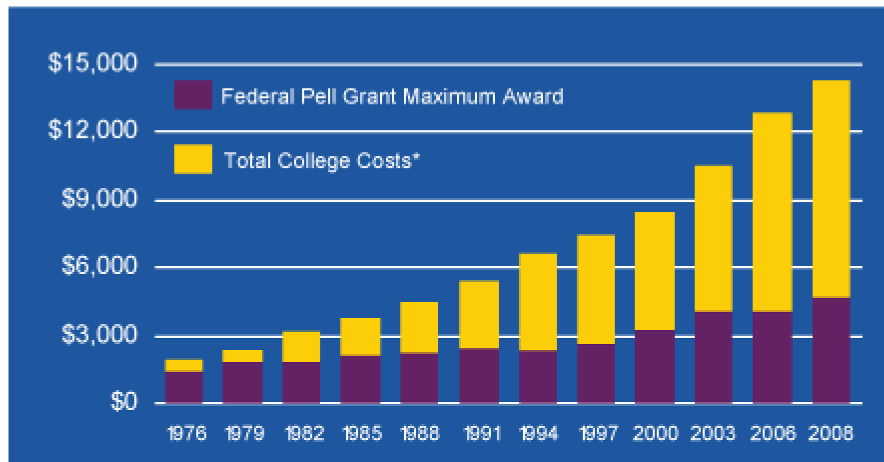
[2] Thanks to Robert Baker, Economist, Division of Forecasting, and Washington Office of Financial Management for help in calculating labor participation and population data...

6. The Problem - The Cost of College

The most important indicator of regional economic success is the number of residents who have completed a college degree or certificate. The problem is that the economic payoff from college occurs after completion of the program, so the costs precede the benefit. In addition, the costs are substantial. Tuition and fees at Washington Community and Technical Colleges have risen by 50% over the past five years.[3] The average cost of tuition, books, fees *and the cost of living*[4] for community and technical college students in Washington State is $17,044.[5] Even low-income independent students actually receiving Pell Grants and the State Need Grants face an average unmet need of $6,400 per year.[6] This imposes an unsustainable burden on low-income and low middle-income students.

Perhaps most importantly, eligibility for Pell Grants, low interest Stafford Loans and the Washington State Need Grant is limited to families with incomes of under roughly $40,000. For example, a grocery clerk with a child earning $45,000 per year would be ineligible for aid. Lost earnings for attending college as well as other college costs would take up over 40% of the family's income.

Federal Pell Grants: Maximum Awards & Total College Costs*



* Includes tuition, fees, room, and board at a public, four-year university or college.Selected fiscal years, 1976-2008.
Source: U.S. Department of Education, Congressional Research Service, and The College Board.

-

The obvious solution would be to expand traditional financial aid programs, which have failed to keep up with the soaring cost of college. The proportion of college costs covered by Pell Grants has fallen dramatically over the past 30 years, and now covers the lowest portion of costs in history. In the state of Washington, budget cuts to the State Need Grant have left 32,000 students, or 30% of the eligible students, without aid. Moreover, because of federal budget cuts in 2011, Federal Pell Grants no longer cover summer programs. [7]

---

[3] Washington Higher Education Coordinating Board, 2012, *Key Facts About Higher Education in Washington.*

[4] The cost of living is included in this figure since students who work more than half time are unlikely to complete programs. Program completion requires students to forgo earnings to attend college.

[5] Scott Copeland, State Board for Community and Technical Colleges, July 9, 2012; Higher Education Coordinating Board, January 2004, Key facts about higher education in Washington (adjusted for inflation)

[6] Washington State Higher Education Loan Program Work Group, December 2012, *Higher Education Loan Program Legislative Report*

[7] Washington State Higher Education Coordinating Board, January 2012, Access, Affordability, Achievement: Annual Report on State Financial Aid Programs

The next best solution would be expansion of existing student loan programs. However, many working adults have little history or understanding of personal finance and borrowing. Students fear indebtedness in a time of high unemployment and mortgage foreclosures. Many colleges have not offered federal students loans because of penalties related to the high default rate. Private loans are only offered at very high interests, if at all, for lower income working adults.

7. Complexity

Behavioral factors often play a bigger role in decision-making than financial or economic factors. For example, all of us tend to discount current losses compared to future gains. This factor, known as "hyperbolic discounting," is true for all of us. We are unlikely to risk $.50 cents today for $1.00 next year despite the return on investment. Consequently, more than 80% of all Americans have a negative personal savings rate. This tendency becomes magnified for low-income families where earnings are barely able to keep up with daily life expenses.

All of us are loss averse. Potential losses loom larger than gains. We overvalue what we already have and discount what we may get in the future. Research on loss aversion indicates that we require gains equal to double of that of the current loss. That factor is magnified again when the loss is potentially ruinous or your lifestyle is threatened.[8] Are you willing to lose $35,000 right now in exchange for $15,000 in additional income over the next ten years? That is the risk many low-income students face.

We also tend to base our decisions on our experiences rather than theoretical projections offered by other people. Lower-income families have little experience with college and thus the gains seem far more uncertain. The combination of risk aversion and complexity not only leads to an aversion to borrowing but an aversion to seeking and receiving financial aid.

When confronted with a high-risk decisions like investing in college, small barriers can become huge barriers. This starts with the process of seeking financial aid. According to the Advisory Committee on Student Financial Assistance, "Millions of students and adult learners who aspire to college are overwhelmed by the complexity of student aid. Uncertainty and confusion rob them of its significant benefits. Rather than promote access, studies show that aid often creates a series of barriers - a gauntlet that the poorest students must run to get to college." [9]

The Free Application for Federal Student Aid (FAFSA) is the form that students need to fill out to get either state or federal financial aid.

Research indicates that there are three major barriers to students filling out a FAFSA.

1) **The complexity of signing up for the FAFSA:** Recent research demonstrates that very small difference in sign-up procedures can lead to large differences in program participation. [10] The complexity of the FAFSA form itself is a major deterrent. The form is four times longer than the simplest tax form. The form is eight pages long and contains over 100 questions. To answer three of these questions, applicants had to complete three additional worksheets with nearly 40 additional questions.

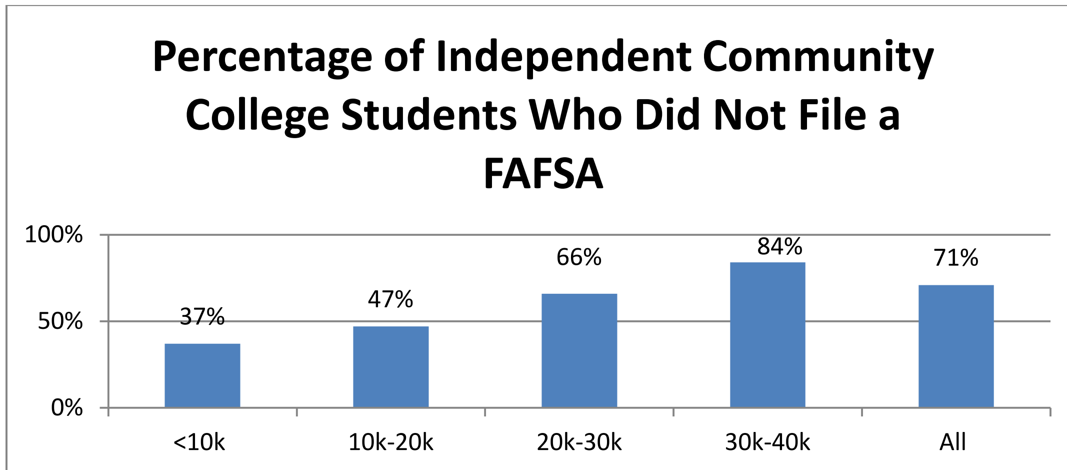
2) **Application deadlines** - Most of the state and institutional aid programs set a deadline of April to May 1 to file. Those who apply later are less likely to receive aid. The share of applicants receiving state aid dropped from 34% among those who applied before March to 30% among April and May applicants, to 20% for those applying in June or later. Individuals cannot submit the FAFSA until January of the year of college entry. Students apply to college before knowing with certainty whether they can afford it. Generally, state financial aid is awarded in the fall and funding generally runs out for students who enter in later quarters. [11] At many colleges, staffing cutbacks have

[8] Hahnemann, (2011) *Thinking Fast and Slow* Farrar, Strauss and Giroux
[9] Advisory Committee on Student Financial Assistance. (2005). "The Student Aid Gauntlet: Making Access to College Simple and Certain." Final Report of the Special Study of Simplification of Need Analysis and Application for Title IV Aid. Washington, D.C.: Department of Education.
[10] Bettinger, Long, Oreopoulism Sanbonmatsu, 2009, *The Role of Simplification and Information in College Decisions,* NBER working paper 15361
[11] Jaquieline, King (2004) *Missed Opportunities: Students Who Didn't Apply for Financial Aid,* ACE Issue Brief. The source of data for this study is the National Postsecondary Student Aid Study by U.S. D.O.E.

resulted in backlogs for processing student financial aid applications. The result is that many students have to pay their fall tuition without financial aid, or have had to delay enrollment to winter quarter.[12]

3) **Awareness of financial aid** - Low-income adult students have less information than other families on how to pay for college. Only 12% of low-income students and parents were able to estimate the actual cost of college.[13] Participants in one study overestimated the cost of college by over 300%.

According to the American Council on Education, , the consequence is that nearly 40% of low income adult community college students did not file a FAFSA and almost 70% of the students earning $20,000 to $30,000 did not file.[14]



Academic and financial counseling is the key to overcoming the complexity problem. A 2009 study using a sample of nearly 14,000 students compared application for the FAFSA, enrollment and program completion using three different levels of financial counseling. The program provided data on independent adults with no college experience.

- Group 1 received direct one-on-one counseling where they discussed, reviewed, and filled out the FAFSA form. They were provided immediate personalized aid estimates along with the net tuition cost for nearby colleges.
- Group 2 received all of assistance of the first group but did not receive help filling out the FAFSA.
- Group 3 (the control group) received only a brochure on the importance of higher education and general information on college costs and financial aid.

The results were impressive. While only 13.7% of the control group filed a FAFSA, almost 40% of Group 1 filed. There was little difference between the control group and group 2. Additionally, students who participated in group 1 filed their FAFSA over a month earlier, giving them a significantly higher chance of getting both state and federal aid over those who file later.

The study indicated that the costs of the enhanced one-on-one counseling were minimal. The interviews lasted 8 minutes and cost about $20 per participant and included tax professional training and time, software installation, maintenance and printing and participation incentives. Given the low participation rate by low-income adults, the financial counseling component made a big difference. Financial counseling not only results in a higher rate of financial aid; it also provides consumers with more insight into the risks and benefits of borrowing.

---

[12] Seattle Community College, November 2012, Federal direct Student Loan Work Group, Report to the Chancellor and Presidents

[13] Horn, Laura J., Xianglei Chen, and Chris Chapman. (2003). *Getting Ready to Pay for College: What Students and Their Parents Know About the Cost of College Tuition and What They Are Doing to Find Out*. National Center for Education Statistics Report No. 2003030, Washington, D.C.: National Center for Education Statistics.

[14] American Council on Education, October 2004, Missed Opportunities: Students Who Didn't Apply for Financial Aid, Issue Brief

A Georgetown University study found that one-on-one financial counseling also has the effect of improving student credit scores and promoting greater financial responsibility. The study found that borrowers with initial Empirica scores (credit ratings) at the lowest 10th percentile who received counseling experienced an average net increase of 36.3 points in their Empirica scores over the three year period, relative to borrowers with the same initial Empirica score in the comparison group.[15]

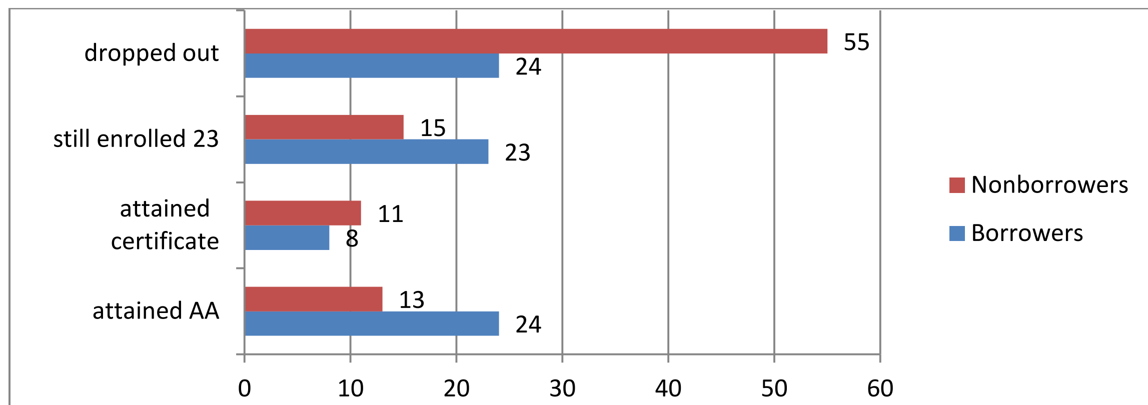
Inadequate financial support leads to both decreased enrollment and completion. Dynarski, in a 2001 study, examined the impact of the Social Security Higher Education program that provided tuition benefits for the children of beneficiaries. Unlike the FAFSA, the application for aid is simple - students were sent a letter indicating their eligibility with a half-page form to fill out. The study found that eligibility for the social security benefits college program increased attendance by 24% and completion by 16% or ***3.6% for each $1,000 of grant aid*** offered.

8. The Cost of College is the Biggest Barrier to College Completion

Paul Attewell, Scott Heil and Liza Reisel authored a 2010 study which found that, "For students who enter two-year colleges, financial aid has a statistically significant and positive relationship to graduation: It is the single strongest predictor of graduation."[16] A study by the National Center for Public Policy and Education found that twice as many students who borrowed were likely to complete than non-borrowers. [17] The reason appears to be that borrowers are significantly less likely to work full time, and thus are twice as likely to enroll full time.

Borrowing and Completion for Freshmen at Community Colleges

(Percentage of borrowers and non-borrowers who attained the identified status six years after enrolling)



A 2011 study by Attewell, Heil and Reisel in the *American Educational Research Journal* found that "for students who enter community and technical colleges, financial aid has a statistically significant and positive relationship to graduation. It is the single strongest predictor of graduation." The study also found that non-traditional status – going to school part-time and having dependents – results in considerably lower graduation prospects. Surprisingly, the study found that academic preparation is not a significant predictor for students after other factors have been controlled.[18]

North Seattle Community College does an annual attrition survey of students who left within the first 10 days, nearly one

---

[15] Elliehausen, Lundquist, and Staten (2003), *The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior,* Credit Research Center, Georgetown University

[16] Paul Attewell, Scott Heil and Liza Reisel, December 2010, *Competing Explanations of Undergraduate Noncompletion*, Am Educ Res J 2011 48: 536

[17] Gladieux and Poerna, May 2005, *Borrowers Who Drop Out: A Neglected Aspect of the College Student Loan Trend*, National Center for Public Policy and Higher Education. The study is based on the longitudinal study Beginning Postsecondary Students by the U.S. Department of Education. The study had a sample size of nearly 1.5 million students.

[18] Attewell, Heil and Reisel, (May 2011) *Competing Explanation of Undergraduate Completion,* American Education Research Journal Volume 48, no. 3.

third left because they couldn't afford it or it was incompatible with their job. The number two reason was leaving because of competing demands on their schedule.[19]

Focus groups with financial aid and WorkSource staff indicate the cost of college becomes the biggest problem for students who are nearing the end of their programs. Students simply run out of money as the program goes on. During the first half year, unemployment benefits or savings help pay for living expenses. However, a year later, savings run out and unemployment expires. Or, life simply intervenes. The car stops working, someone in the family falls ill or another member of the family loses his or her job.[20]

9. The Importance of College Completion

The financial success of the College Completion Fund that we are proposing is largely determined by the success of the student in completing a program and getting a good job. Students with higher incomes and stable jobs are significantly less likely to default on financial aid obligations.

The Washington State Workforce Training and Education Coordinating Board (WETECB) recently completed an impact study of workforce education programs in Washington State. A subset of the data from this report compares completion rates of programs with employment and earnings of students three quarters after they exit the program.

Looking at all of the program completers from Washington State Community Colleges during the 2010-11 school year, completion made a big difference in economic success. Completers are 20% more likely to find employment and earn an annual income 31% higher than non-completers.[21]

	All	Completers	Non-Completers
Percentage with employment reported by employers to ESD third quarter after leaving program	63%	69%	56%
Median quarterly hours worked of those working	416	429	403
Percentage employed full-time of those working (averaging 30 or more hours/week)	54%	56%	51%
Median annualized earnings of those working	$24,413	$26,726	$20,476
Median annualized earnings of those working and not enrolled in further education	$24,825	$27,204.96	$ 21,581
Size of household in which median earnings would support at poverty level	4.5	5.1	3.5
Size of household in which median earnings would support at twice poverty level	2.7	3.3	1.7

[19] North Seattle Community College, May 2012, Annual Attrition Survey
[20] Focus group with Opportunity Center financial staff, October 12, 2012, Seattle, Washington
[21] Workforce Training and Educating Coordinating Board, 2011, Workforce Training Results (net impact study) review of data subsets from the research.

A 2005 study by David Prince and Davis Jenkins demonstrated comparable results, indicating that students who completed at least one year's worth of college credits and earned a credential had an average earnings advantage of $7,000 for students who started in ESL programs and $8,500 for those who started in a GED or ABE program.[22]

Not surprisingly, there is a strong relationship between program completion and loan repayment. Podgursky, Ehlert, Ryan, Monroe and Watson studied the relationship in Missouri community colleges and universities. They found that within windows ranging from two to eight semesters, students who are continuously enrolled or who complete their program are far less likely to default than are students who drop out during the same period.[23] Cunningham and Kienzl found that students who complete programs are twice as likely not to default or fall behind in payments as students who do not complete. Nearly half the students who did not complete fell behind in payments, and 26% went on to default.

10. Factors that Lead to Completion

The strong relationship between completion, employment, earnings and loan repayment makes completion a key predictor of program success. The factors that lead to completion should be on the checklist that is used in underwriting.

a) The **entrance of students into a specific program of study** has been shown to be a key determinant of completion. Davis Jenkins and Sung-Woo Choo compared the date of entry into a specific program and completion rates in a 2012 study[24]. The study compared students who entered a specific program of study with students who merely registered without choosing a clear career pathway. Students who entered a specific career program within the first year had completion rates of over 60% compared to 40% of all the students in the cohort. Community and technical colleges have pathway programs that are often cohort based, where students go in as a group and follow a common pathway of courses to reach a certificate or degree. Targeting loans to these programs would vastly reduce default risks.

b) The number of hours students **work outside of college** could be the biggest factor affecting student completion, success and loan repayment**.** Several studies have found that students who limit employment to 10 or 15 hours per week are more likely to stay enrolled and earn degrees or certificates.[25] A recent Bill and Melinda Gates Foundation survey of students indicated that "The number one reason students give for leaving school is the fact that they had to work and go to school at the same time and, despite their best efforts, the stress of trying to do both eventually took its toll. More than half of those who left higher education before completing a degree or a certificate say that the "need to work and make money" while attending classes is the major reason they left.[26] The graph below from the Community College Research Center compares the number of hours worked to credit accumulation. The longer it takes to finish, the less likely it is that students will complete.

---

[22] Prince and Jenkins 2005

[23] Podgursky, Ehlert, Ryan, Monroe and Watson, *Student Loan Defaults and Enrollment Persistence* Journal of Student Financial Aid, v32 n3 p27-42 2002

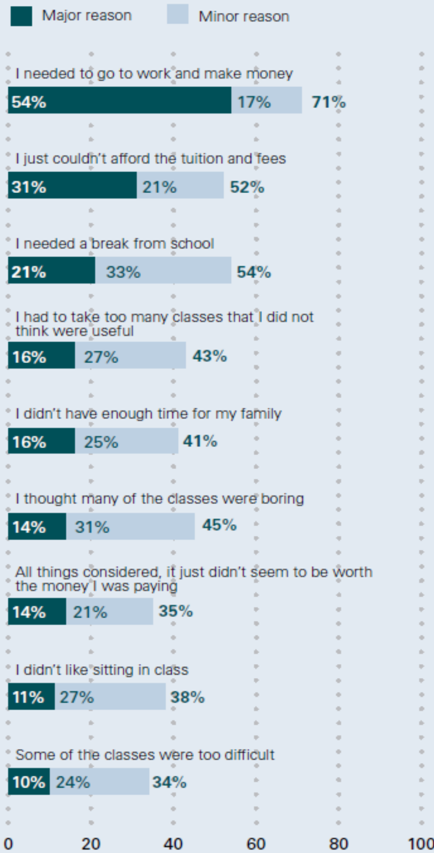
[24] Jenkins and Cho, "Get with the Program: Accelerating Community College Students' Entry Into and Completion of Programs of Study", Community Research Center Working Paper No. 32, January 2012.

[25] Orozco, V. & Cauthen, N.K. 2009. *Work Less, Study More & Succeed: How Financial;* Burdman, Pamela, Institute for College Access & Success (TICAS) and the California Community Colleges Student Financial Aid Administrators Association (CCCSFAAA (July 2012) *The Student Loan Default Trap*

[26] Johnson, J., & Rochkind, J. (2009). With their whole lives ahead of them (Report Prepared for the Bill and Melinda Gates Foundation). New York, NY: Public Agenda.

Having to work is the top reason young adults give for why they left school.

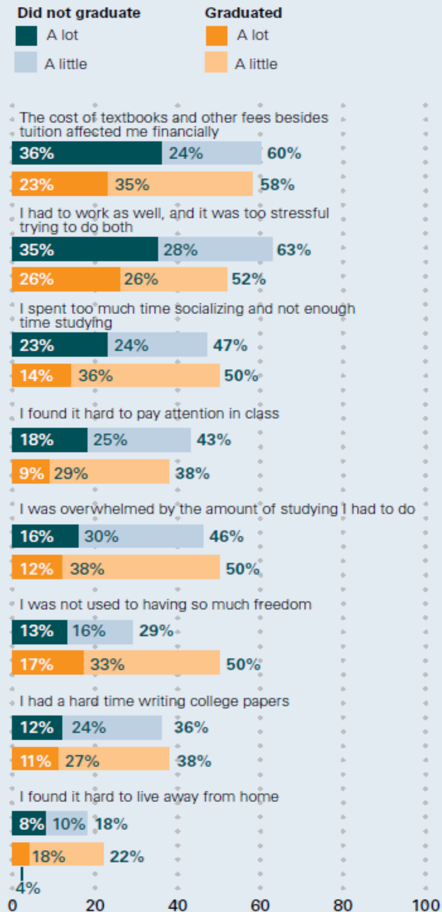
Percent who say the following is a reason why they did not complete their program:



Base: 22–30-year-olds who did not complete their postsecondary education.

Those who did not complete had trouble balancing work and school in their first year of higher education.

Thinking about your first year in school, please tell me if the following describes you:



Base: 22–30-year-olds with some postsecondary education.

Note: Question wording in charts may be slightly edited for space. Full question wording is available in the Full Survey Results at the end of this report. Percentages may not equal 100 percent owing to rounding or the omission of some answer categories.

c) **Support Services, Counseling and Advising**: The State of Washington's Opportunity Grant program is a model of enhanced services for low-income students. The program provides an additional per FTE allocation for support services and advising of $1,500 per FTE. Research indicates that the proportion of Opportunity Grants students who enroll in the Fall and were still enrolled in Spring was 89% as compared to 62% for low-income students as a whole. For part-time students the difference was 84% for Opportunity Grant students compared to only 42% for other low-income students.[27]

[27] State Board for Community and Technical Colleges, (October 2008) Opportunity Grants: A Progress Report

In 2004, The Workforce Training and Education Board survey asked community college financial aid officers the question, “To what extent do you agree that doing one or more of the following actions would result in increased student success at your college?” By far the strongest response was providing comprehensive support services, including childcare, transportation assistance, career counseling, academic advising, and assistance with obtaining financial aid. Over 75% strongly agreed with th3 statement and 22% agreed.[28]

11. Student Loans

The federal loan program, known as Direct Student or Stafford Loans, is by the far the largest loan program in the country. In fiscal year (FY) 2013, new Direct Loan volume is estimated to be $121 billion. From 1965 to 2010, private banks managed federal student loans under the Federal Family Education Loan (FFEL) program. FFEL loans were made through private financial institutions. From its inception in 1965 through the end of June 2010, the FFEL program provided almost $899 billion in student loans to postsecondary students and their parents. With passage of the Health Care and Education Reconciliation Act of 2010—a portion of which is also known as the Student Aid and Fiscal Responsibility Act (SAFRA)—the FFEL program ceased making new loans as of July 1, 2010. Lenders will continue to service those outstanding FFEL loans.[29]

Now the vast majority of federal loans are made through eligible institutions of higher education through the Stafford Direct Student Loan Program. There are two types of loan programs: subsidized and unsubsidized. Subsidized loans are available to low-income students and carry an interest rate of only 3.4% and interest does not accrue until after leaving college. The unsubsidized loans are available to all students who are enrolled more than half time and carry an interest rate of 6.8%.

Unlike private loans, no credit check is necessary for a Stafford loan. The risk pool is so large for Stafford loans that the credit risk is spread across a large population. Consequently, Stafford loans offer a single simple interest rate. Private loans carry interest rates of 2.8% to 25% depending on the student’s income and risk. Stafford loans also allow for a three-year hardship period during loan repayment. During this period, no interest is accrued and loan payments are postponed. Private loans rarely offer similar terms.

[28] Workforce Training and Education Coordinating Board, (November 2006) *Workforce Education Financial Aid and Student Access and Retention A Report to the Washington State Legislature*
November 2006

[29] Department of Education STUDENT LOANS OVERVIEW Fiscal Year 2013 Budget request

Loans and Terms for Stafford and Private Loans for Community College Students			
	Subsidized Stafford	Unsubsidized Stafford	Private Loans
Eligibility	Students with financial need, enrolled at least half time, no credit check; college must participate in federal student loan program.	Any student enrolled at least half-time, no credit check; college must participate in federal student loan program.	Requires credit check and co-signer.
Maximum Amount	$3,500 for freshmen. $4,500 for sophomores	$9,500 for freshmen $10,500 for sophomores	Most available for up to cost of attendance minus other aid.
Interest Rates	3.4% expires September 2013 reverts to 6.8%	6.8%	Up to 25%
Charges during school year	None	Interest accrues	Interest accrues and payments due.
Hardship policy	No payments required and no interest charged for three years of economic hardship.	No payments required but interest charged accrues for three years of economic hardship	Not available
Income-based repayment	Available	Available	Not available

If student loans were available at subsidized interest rates, without credit checks, why would we need a private lending program?

1) **Income eligibility standards are too low:** Students earning over $40,000 per year are generally ineligible for the 3.4% rate.

2) **Not all colleges offer Federal Loans:** During the 2009-10 academic year 9.5% of the community colleges in the U.S. and 10.5% in Washington did not offer federal student loans. The largest community college district in Washington, the Seattle District, does not currently offer federal loans. Credit restrictions severely limit access to private loans. Only 5% of Seattle students are taking out private loans. There are two reasons why federal loans aren't offered:

    a. **Default risks to colleges**: Federal law penalizes colleges with default rates over 25% for three years in a row or 40% in one year. Penalties include student loss of eligibility for federal grant program such as Pell Grants. Seattle Community Colleges stopped participating in the program in 1998 to avoid the sanctions. The default rate at Seattle Central Community College exceeded 40% at the time.[30]
    b. **Costs to Colleges:** Significant cutbacks in state funding have reduced the number of academic and student aid counselors on college campuses. College financial aid offices have reduced hours open to students, and backlogs for determining financial aid eligibility range from four to six weeks. [31] There are generally 2,000 students per financial aid counselor in Washington State community and technical colleges. Seattle Community College administrators indicate that they

[30] Seattle Community College, Federal direct Student Loan Work Group, November 2012, *Report to the Chancellor and Presidents.*
[31] Seattle Community College, Federal direct Student Loan Work Group, November 2012, Report to the Chancellor and Presidents

would be unable to provide financial counseling and process student loans without additional financial resources.

3) Lending Limits: College staff and researchers indicate that the biggest problem with federal loans is the lending limit is too low. Students eligible for subsidized Stafford Loans are limited to $3,500 per year and for unsubsidized loans, $9,500. Given an annual cost of college of $17,000 per year, for many students just above the financial aid line, loans will cover a little over half of the cost of college for independent adult students.

4) **Eligibility limits:** Many students are ineligible for federal loans and grants. These include:

   a. Most immigrants and all Illegal immigrants.
   b. Student attending college less than half time
   c. Students who have defaulted in the past
   d. Students who do not have a high school diploma or GED
   e. Students with past convictions for possessing or selling illegal substances that are still on their record.

These restrictions particularly hurt working adults with families. Working students with family responsibilities, who often only have time to take one or two classes a quarter are ineligible. Students who dropped out of high school and have been working for a while will be forced to take a GED sequence before they can begin any job specific training.

5) **Payments and Interest rates**: Federal loans provide a subsidized interest rate of 3.4% for low-income students and a nonsubsidized rate for other students of 6.8%. The subsidized rate of 3.4% for low-income students expires on July 1, 2013, and will revert to 6.8%. This appropriation is quite vulnerable to further deficit reduction cuts. Interest rates can make a big difference in monthly payments for students. For a $10,000, five-year loan, a rate subsidized at 2.0% would only equal 7.8% of family income (at $27,000 – the average earnings three quarters after completion) as compared to 9.9% of family income for an unsubsidized private loan at 12%.

The question is whether the difference in monthly payments is meaningful. The monthly payment for a community development finance loan at 2% and a Stafford rate of 6.8% is $12 per month. Is that amount a major deterrent to enrollment and completion of college? Alternatively, would resources be better put to use in counseling and support services?

Annual Loan Payments as a Percentage of Income for Various Terms and Interest Rates *				
Rate/terms	2% - target rate	3.4% - subsidized federal direct	6.8% -unsubsidized federal	12% Private loan
5	$175.28 per month pmt. Or 7.8% of income	$181.47 8.1%	$197.07 8.8%	$222.44 9.9%
10	$92.01 4.1%	$98.42 4.4%	$115.08 5.1%	$143.47 6.4%
*Assumes annual income is average of completers three quarters after completion. Assumes $10,000 loan over two years.				

12. State and Credit Union Student Loan Programs

The state of Washington is currently considering the development of a state student loan program. A December 2012 report from the Higher Education Loan Work Group[32] is recommending that the state consider three different models:

1) The first option is selling revenue bonds. The State Treasurer could sell the bonds backed by the full faith and credit for the state. The Student Achievement Council would provide the loans to students. The Work Group report suggested looking at Washington Lottery funds as a revenue source. According to the report, several states (Minnesota, Alaska, New Jersey and Texas) use revenue bonds to support their student loan programs.
2) The second option would be for the state to guarantee private loans from credible financial institutions. This is similar to option 3 in the previous discussion in this paper.
3) The third option would be the creation of a state bank that provides funding for the student loan program. North Dakota has a state bank and legislation has been proposed over the last few sessions to create one in Washington State.

Currently, few financial institutions in the state of Washington offer student loans. Two credit unions in the state – BECU and GESA Credit Unions – participate in the national Credit Union Student Choice Program. They issue more than $50 million in student loans, serving 2,400 students. However, all the loans must be co-signed. Such loans would likely require a guaranty and servicing fee for each loan approved. The Workgroup report suggested a loan loss reserve of 8% to cover the loans.

During the 2010 legislative session, the legislature passed a bill creating a state guaranteed Aerospace Loan Fund. The Fund was established because the Aerospace program was less than half time, and thus participating students were ineligible for

[32] Higher Education Loan Program Work Group, (December 2012) *Higher Education Loan Program Legislative Report*, Washington State Student Achievement Council.

federal loans. The Fund makes loans to students participating in a 12-week training program in the aerospace industry. The loan is entirely paid for by the student and is managed by the Student Achievement Council.

13. Risk

Student loans are risky. A recent study revealed that more than half of student loan accounts are in deferred status, where the repayment of the principal and interest of the loan is temporarily delayed. Deferred loans now represent 43.5% of all student loan balances.[33]

Unlike other comparable loans, there is no collateral. Benefits to students are uncertain. Students can end up graduating into a weak job market where they are unable to make loan payments. Unforeseen family circumstances can result in students dropping out and not even receiving a wage premium from college. Over 20% of all community college students will default on their student loan sometime during the loans' term.[34]

The basic problem is that the students who are most in need of financial help are the most likely to default. A loan program targeted to the neediest students will have significantly higher risk and default rates than programs with a very large and diverse pool of students. Furthermore, even the federal Direct Student Loan program, with a huge risk pool, has very high default rates compared with any other loan products except for mortgages (mortgages exceeded other loan defaults only in the 2007-10 period due to the financial collapse).

A student loan is considered in default if a payment is not made within (typically) 270 days, and arrangements with the lender have not been made. Default rates help to gauge the cost of federal student loan programs. According to the U.S. Department of Education (DOE), on average, the federal government is not able to fully recover losses when a borrower defaults on a federal student loan. These defaults can be costly for the government because it often takes many years to collect on a defaulted loan.

There is a considerable amount of data collected on the risks of student loans from the federal Stafford Loan Program. The DOE calculates three types of default rates to track the level of risk for the program:

1) The cohort default rate is a measure of the **percentage of federal loan borrowers** in the federal Direct Student Loan Program that entered repayment during a given federal fiscal year and defaulted before the end of the fiscal year.

2) The Cumulative Lifetime Default Rates measure **the percentage of all federal loans that entered repayment in a given fiscal year and have defaulted at some point** since, calculated through the most recent fiscal year. The cumulative rate is only published at the national level.

3) The Budget Lifetime Default Rate estimates the **percentage of loan volume** that enters repayment in a given year and is expected to go into default over the following twenty-year period. The Budget Lifetime Default Rate is calculated and reported in the President's budget proposal for a given fiscal year and the two preceding fiscal years, and is used as a predictor of program costs. It is not calculated for loans made at individual institutions of higher education, for states, or by institution type.

[33] Transunion, January 30, 2013, "More Than Half of Student Loans in Deferment; High Unemployment Rates Put Loans at Risk".
[34] Gladieux and Pena, May 2005

The below chart illustrates national default rates and a sampling of regional colleges.

Area	Cohort Default (2010)	Cumulative Default (2009)	Budget Lifetime (2011)
U.S. Total	10.0%	20.9%	31.1%
Bates TC	16.9%		
Tacoma CC	10.3%		
Spokane CC	14.2%		
Renton TC	9.3%		
Portland CCs	12.0%		

Loans to community and technical college students are particularly risky. Credit Union Student Choice, an organization that supports Credit Union student loan programs even recommends lending to community and technical college students.[35] Using the cumulative default rate, fully one-fifth of all community college student loans result in a default at some point during the life of the loan, equaling nearly one-third of the loan volume Cohort default rates vary widely by college, ranging from 9% to 17%. These default rates represent considerable risk, and compare poorly to other loans made to low-income populations.

For the purposes of this study, the budget lifetime rate is important for estimating the costs to the lender. While nearly a third of the loan volume may be in default, the federal government is able to collect on these loans. The U.S. Department of Education publishes data on how successfully it collects on federal student loans that have defaulted. This information is an important indication of the cost borne by the federal government when borrowers default. Costs include unrecovered principal and interest, payments made to private collection agencies to recover defaulted student loans, and the cost of time that elapses during missed payments (i.e. the time-value of money). DOE is able to collect 80% of its costs for *all* Stafford Loans.[36] Although default rates on student loans are very high relative to default rates on other forms of debt, such as auto loans and credit cards, recovery rates are considerably higher, which limits the fiscal impact of student loan defaults. However, adjustment for risks and administrative costs are included, the program runs a net loss of 11%.[37]

This is not particularly reassuring since the most of the data is for all institutions including four-year colleges. Community colleges have default rates two and one half time higher than four year institutions. Given the low-income population at community colleges, the ratio for collection is likely to be even higher. Unlike private loans, the federal government has extraordinary powers to collect student loans, far beyond those of most unsecured creditors. The government can garnish a borrower's wages without a judgment, seize his or her tax refund, including an earned income tax credit, seize portions of federal benefits such as Social Security, and deny eligibility for new education grants or loans. Even in bankruptcy, most student loans must be paid. Unlike any other type of debt, there is no statute of limitations for these loans.

Federal loans provide a number of options to student borrowers who are unable to make payments on their debt. In general, these terms are much more generous than options that are available with other forms of debt, and the cost of managing these provisions is very high. Among these are modified repayment plans, deferment, and forbearance. Deferment allows borrowers to stop making loan payments if they are enrolled in school at least half time; currently serving on active duty (including performing qualifying National Guard duty during a war, other military operation, or national emergency); engaged in a full-time rehabilitation training program; or in cases of economic hardship, including unemployment, receipt of public assistance, Peace Corps service, and certain other income limitations. Forbearance allows those who do not qualify for a deferment to stop making student loan payments, temporarily make smaller payments, or extend the time for making payments. Common reasons for forbearance listed by the Department of Education are illness,

[35] What's Missing In Much of the Student Loan 'Analysis' Credit Union Journal | Monday, December 10, 2012
[36] Federal Education Budget Project (2012) *Federal Loan Default Rates*
[37] Edmiston, Brooks and Shepelwich (2012) *Student Loans: Overview and Issues* Federal Reserve Bank of Kansas City

financial hardship, or serving in a medical or dental internship or residency. A forbearance can automatically be granted while processing a deferment, forbearance, cancellation, and change in repayment plan, or consolidation, or if the borrower is involved in a military mobilization or emergency. Interest does not accumulate under deferment, while it does under forbearance.

Data on the proportion of loan dollar volume in default as well as collection rate by type of institution and characteristics of borrowers is not available. However, there is a considerable amount of data on cohort default rates. Consequently, the cohort default rate serves as proxy for risk. The major problem here is that risk varies considerably with the characteristics of the population.

Data compiled by five different researchers in refereed academic journals shows that default rates vary widely with the characteristics of the borrowers. Black students and single students with dependents are the most likely to default. Not surprisingly, students with low-paying jobs and students who did not complete programs defaulted at rates between 27% and 45%.

1) Single with dependents	**52%**
2) Very low earnings	**35% - 45%**
3) Non-completion	**27% - 36%**
4) Married with dependents	**24%**
5) Unemployment	**23%**
6) Debt Burden <5	**21%**

The table on the following pages provides more detail. It is interesting to note that the amount of debt burden is inversely related to default. This could be because lower income students borrow less. The relationship to age appears indefinite. If there is a trend, it appears that older students have higher default rates.

There are apples and oranges in these numbers. Most of them include both four year and community colleges and only Dynarski's data was based entirely on community college students. However, you can clearly discern a trend by comparing the various categories.

A recent Federal Reserve Bank of Kansas City study found that a critical factor in delinquency is high unemployment. Unemployment clearly reduces income, usually very substantially, which makes any payment a considerable burden for most. Moreover, a large fraction of unemployed borrowers defaults on their student loans. Unemployed borrowers had a default rate over twice the rate for employed borrowers (for all students including those who attended four-year colleges).[38]

[38] Edmiston, Brooks and Shepelwich (2012)

Factors and Default Rates [39]	Dynarski 1994*	Cunningham and Kienzl 2005	Volkwein and Bruce P. Szelest 1995	Kesterman 2006[40]	Woo 2002
Institution type					
For profit 2 year	31.5%	36%	28.5%	30.3%	29.0%
Community college	25.6%	24%	26.2%	28.3%	23.0%
Four-year public	10.6%	10%	13.8%	19.7%	8.8%
Completion *					
Non-completers	31.2%	27%	35.7%		
Completers	19.5%	15%	13.9% **		
Age *					
Under 21		8%			
21-24		29%			
25-29		25%			
21-30	15.5%				
Under 30			13.8%		
30-44		27%			
31-40	17.8%				
30-49			19.7%		
>40	23.6%		34.3%		
>45		11%			
Race/ethnicity *					
White	20.2%		14.5%		
Black	54.7%		61.4%		
Hispanic	37.8%		26.8%		

[39] **Completers are those who attained an AA degree. * Dynarski's data on age, average annual earnings, completion and race is for community colleges only.

[40] Kesterman, (2006) Student Borrowing in America: Metrics, Demographics, Default Aversion Strategies, Journal of Student Financial Aid.

Dependents					
None	13.1%				
Single none			16.7%		
Single dependents			51.9%		
Married none			14.8%		
Married dependents			24.0%		
1-2 dependents	24.1%				
>2 dependents	31.5%				
Average Annual Earnings *					
<$10,000	48.0%		35%		
$10k-15	26.3%		23%		
$15K-25	22.2%		21%		
>25	10.9%				
>45			6.7%		
Interest Rate					
7%			16%		
8%			20%		
9%			14%		
Employment					
Unemployed					23.2%
Employed					9.7%

Volkwei and Bruce P. Szelest found that default rates increased with age, decreased with income and were higher for students of color and students with dependents.[41] Dynarkski in 1994 found that ability to pay and non-completion were the biggest factors in default. For example, the mean probability of defaulting is 0.17, but if post-school earnings were doubled from $11,000 to $22,000, the predicted probability to drops 30%. Program completers had a default rate of 20% versus 31% for non-completers. Cunningham and Kienzl, in a 2011 article, found similar results with non-completers have nearly twice the default rate.[42] Woo identified the crucial factors as being unemployed and completion.[43]

There is also evidence that the number of credits accumulated is an important determinant. Christman found that nearly two-thirds of community college defaulters had been enrolled for less than two semesters, with half dropping out during the first semester. [44]

14. Comparisons with other Community Development Finance Loans

Community Development Finance Institutions (CDFI) promote economic development in struggling areas, both urban and rural, that are underserved by traditional financial institutions. CDFIs play a critical role in building a healthier economy by providing these communities with the access to capital. The U.S. Department of Treasury certifies CDFIs as Community Development Entities giving them access to Federal resources and tax credits. CDFIs provide an array of financial services in their target areas, including mortgage financing for homebuyers, financing for the rehabilitation of rental housing, financing for the building and rehabilitation of community facilities, commercial loans to small and microenterprise businesses, and financial services needed by low-income households and businesses in the target areas

The Federation of Community Development Credit Unions (CDCU) was founded with the specific mission of serving low-income and minority communities beyond the reach of banks and mainstream credit unions. Community Development Credit Unions specialize in serving populations generally considered the hardest to serve, including low-income wage earners, recent immigrants, aging populations and people with disabilities. Washington State has eight CDCUs, six of which are certified as Community Development Entities.

There do not appear to be any CDFI's or CDCUs that make student loans. There appear to be four categories of loans comparable to student loans: mortgage, payday, used and new auto, and small business. Because of their size, length and collateral, mortgage loans are simply not comparable to student loans. Payday loans are small and are directly linked to a paycheck. Auto loans appear comparable in size to student loans as well as terms. However, unlike student loans, auto loans have the car as collateral. The following table compares several comparable loans in terms of volume, terms, size, and default rates.

Credit unions do make student loans through the Credit Union Student Choice Program. BECU and GESA Credit Unions in Washington are linked to the program. They currently issue more than $50 million in student loans to more than 2,400 students. However, all loans must be co-signed, which helps keep the default rate very low. [45]

---

[41] J. Fredericks Volkwein and Bruce P. Szelest, 1995, INDIVIDUAL AND CAMPUS CHARACTERISTICS ASSOCIATED WITH STUDENT LOAN DEFAULT, Research in Higher Education, Vol. 36, No. 1, 1995
[42] Cunnigham and Kienzl, March 2011, Delinquency: The Untold Story of Student Loan Borrowing, Institute for Higher Education Policy
[43] Woo, 2002, *The Causes of Student Loan Default,* EduForum, Rancho Cordova, California.
[44] Christman, 2000, *Multiple Realities: Characteristics of Loan Defaulters at a Two-Year Public Institution,* Community College Review.
[45] Higher Education Loan Program Work Group (December 2012) *Higher Education Loan Program Legislative Report,* Council on Student Achievement.

Financial Institution	**Total loans**	**Average size of Loan**	**Term – length of loan and payback**	**Default rate**	**Guarantee fund size – loan loss reserve**	**Interest Rate Range**
Veridian Credit Union Payday Alternative Loan	$2,504,780	$910	6 months	1.8%	½ of loan is deposited into savings account until loan paid in full	19% to 21%
St. Louis Community Credit Union Freedom AutoMoney Loan	$134,000	$1,000 minimum/ $7,000 maximum	24 months	5%		24% to 26%
Freedom First Credit Union Responsible Rides Auto Loan	$651,244	$9867	60 months	2.8%		9.99%
Wright-Patt Credit Union Stretch Pay Salary Advance	$13,555,123	$550	30 days	1.7%		18%
Missoula Federal Credit Union Payday Alternative Loan	$325,500	$411	90 days	.6%	$500,000	18%
United Credit Union UCU Cash	$89,450	$100 minimum/ $500 maximum	60 days	12.8% of outstanding balances		26% to 36%
Northwest Community Credit Union Paycheck Today Line of Credit	$10,000	$228	Open-end Outstanding balance repaid in full on 5th day of each month	0% to date		18%

15. Costs of Loans

Student loans are likely to be more costly to administer than other types of loans. Kohl Advisory Group provides product cost information based on product cost and profitability assessments completed for credit unions in 2009. [46] It is not clear how comparable these credit unions are, since the clients ranged from $300 million to $1.4 billion in assets. Kohl uses the Activity-Based Costing Approach (ABC). It focuses on activities rather than immediately tracking time and cost to product. ABC first costs out each component of the loan process and then assigns costs to specific activities. They then can compute a direct operating expense percentage by lending product. Add that cost to the cost of money and the level of risk and you end up with the interest rate.

The most recent data indicates these costs:

Classic Credit Cards	11%
Personal lines of credit	7.3%
New Vehicle Direct	0.76%
Used Vehicle Direct	1.47%
Home equity	1.22%
1st Mortgage	0.37%

Unfortunately, Kohl does not yet provide data on student loans. For this reason, we use the used vehicle direct rate as a baseline. Both student loans and used-vehicle loans are somewhat high risk and have similar terms.

The cost of money depends on the source. If donor capital can be raised, the cost of money could range from 0% to 2% leading to a low risk loan (guaranteed) of roughly 1.5 to 3.5%. Otherwise, the cost of money is likely to be linked to the federal funds rate of .25%.

Other than default, the biggest risk is a rapid change in the interest rate. If the credit union has to pay more for money than the income they receive from the loans, the results could be disastrous. While the Federal Reserve Board has committed to low interest rates over the next two years, a risk factor needs to be built in for the probability for higher interest rates.

[46] Kohl Advisory Group, 2010 Product Cost Summary for Credit Unions