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Testimony on Pay It Forward (HB 2662)

House Higher Education, Innovation, and Workforce Development 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.

The Pay It Forward program could serve to discourage students from attending college because it will appear to them as a set tax or fee on an unknown future income that bears no relation to the actual amount of the funds that were loaned.

A Practical Example of Pay It Forward

Based on the income profile for an average Oregon State University graduate, if this program is implemented, OSU will advise students to decline participation and take advantage of more equitable, affordable options.

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 over 20 years, who participates 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 a 20-year average salary of $80,000. (Most students, other than engineers, don't start at an $80,000 salary. But the salaries of nearly all students over the next 20 years will exceed $80,000.)

The lowest average starting salary for an OSU graduate is around $38,000. At a steady $38,000 annual income with no raises 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 unrealistic assumption that the student's salary will never increase over a 20 year work history. A "Pay It Forward" loan simply would never be an attractive alternative to OSU students who are interested in lifelong employment 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. Locking into the program is necessary to make the program work financially, but it creates disastrous 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 given tuition and fees makes up less than 40% of the cost of attendance for an Oregon resident. Students will be required to manage multiple accounts and payments, which studies have 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. They 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 program will be difficult and expensive. Instead of creating another need-based program – Oregon's financial aid directors believe state funds would be much better spent on increasing the appropriations to the Oregon Opportunity Grant Program which is intended to help those students who are most in need.