

To: Higher Education Coordinating Commission
From: Rob Fullmer, Chair, Pay It Forward Workgroup
Re: Workgroup Report on PIF Pilot Design

The enclosed Report contains the Workgroup's recommended design for a pilot program to test, validate and refine a Pay It Forward program.

The Pay It Forward workgroup believes that that HECC recommendations to expand and concentrate funding for the Oregon Opportunity Grant to a cohort of “promising, financially-needy underrepresented students” is an important step for accessibility and affordability for higher education. At the same time, we worry that a large cohort of students and potential students will be left out because of the acknowledged inability to fund:

- the entire cohort of these students, as well as
- working class and middle class students who may not be part of this targeted cohort, as well as
- those students who have been in the workforce for several years and would like to participate in public higher education, including worker training and retraining, as well as
- those students who are “financially needed” but who may not have demonstrated the necessary academic “promise” for support in their junior and senior years of attendance.

Oregon needs to develop pathways of affordability and accessibility for all these students as well, especially if we seek to make the 40-40-20 goal a reality.

Pay It Forward enables higher education access for all these students. And it does so with a financing method that creates a growing higher education trust fund (of new money from the contributions of Pay It Forward participants who have completed their studies) that can then enable future and larger cohorts of students the same tuition-free access to higher education.

Basic Program Design Features for Pay It Forward

The Workgroup recommends an initial pilot program design including 550 new community college participants and 450 new university participants each year. By Year 4, participation will include 4,000 students, and will stabilize at this level. The design includes 20-year contribution periods for all participants, with university participants' contributions set at 4.0% of adjusted gross income (AGI) and community college participants' contributions set at 1.5% of AGI. Participation is voluntary and by credit, so students can choose their own level of support, and consequent proportional Pay It Forward contributions.

Pilot Project Monitoring & Feedback Loop

The Workgroup considered many factors that could influence pilot program performance over time, and carefully sought to define initial contribution terms that were believed likely to be financially sustainable. At the same time, it is our intent and expectation that as economic conditions evolve over time and as we obtain clearer indications of program participation and outcomes, the **initial terms may be modified for future participants** to maintain prudent program expectations.

Sensitivity Analyses and the PIF Pilot

The range of financial performance for the pilot program, and the set of future pilot response options are very important elements of the overall program. A summary of key sources of uncertainty, along with the expected strategy for handling them, is provided here:

- **Minor variables** - Several variables were found to have minor impacts on the PIF pilot's financial performance. These include:
 - Deferred earnings of post-baccalaureate students
 - Distribution of PIF participants according to years of college completed
 - Administrative costs of operating the PIF pilot program
 - Percentage of PIF participants who fail to comply with contribution requirements
- **Potentially significant external variables** - Several other variables were found to have the potential to more significantly affect the financial performance of the PIF pilot.
 - Future increases in tuition in excess of inflation
 - Future increases in income in excess of inflation
 - Adverse selection
- **Reasonable range of variation** - These potentially significant variables were further examined to determine a reasonable baseline value for each and a reasonable - or feasible maximum - range of variation relative to the baseline assumptions. Here are key considerations for each:
 - **Future increases in tuition in excess of inflation** - For the OUS, student tuition already accounted for 72.7% of total costs in 2011-12. That leaves limited scope for continuing the past pattern of shifting costs from state support to tuition. For example, if tuition rose at the historical 1999-2012 4.9% annual rate, in eight years tuition would exceed the cost of education. If indeed this did happen, future Pay It Forward participants under this disinvestment regime would need to contribute 5.5% of income, as opposed to 4% in the current model, for the sustainability of the program.
 - **Future increases in income in excess of inflation** – We assumed no growth in average incomes in excess of inflation. While that was understood to be conservative, incomes have flattened in the past decade and at best will increase incrementally , at least in the near future.
 - **Adverse selection** - The Workgroup assumed no downward adjustment for adverse selection. Several factors influenced this decision:
 - 1) Pilot participants will be selected as a **stratified** sample, based on representative family incomes among other factors; since children's incomes are highly correlated with parents' incomes this will strongly help preserve a representative cohort of future PIF contributors;
 - 2) Parents play a major role in selecting college financing strategy for college students, so that the model for adverse selection is “corrupted” by the financial interest of parents. Their interest may be reinforced toward Pay It Forward by a decade of income stagnation, encouraging transfer of financial responsibility to children who participate in and benefit from Oregon’s higher education system.
- **The simplicity of the design model** enables variables that can be adjusted based on early results from the PIF pilot and agreed to by each new cohort of participants. They include:
 - Raise or lower the participants' contribution rate
 - Extend or shorten the contribution period

Two questions were raised by HECC staff in their draft framework at the August HECC Student Success subcommittee meeting:

- **Could the primary benefits of PIF be captured by a state-based loan program instead?**
- **To what extent does the political and public viability of the pilot depend on its up-front costs being fully “repaid”?**

Primary benefits of PIF vs. a State-Based Loan Program:

1. Tuition-free education with no fixed debt obligation.
 - a. Not possible with loan program.
2. Affordable contributions.
 - a. No guarantee of this with standard loan program;
 - b. If put in place similar to federal Pay As You Earn, a full-scale loan program is probably not financially sustainable by the state
3. Completely covers tuition and mandated fees.
 - a. Not financially achieved by any existing loan program.
4. As the HECC Board enjoins, PIF changes the paradigm to a “public system...organized to maximize student success.”
 - a. Loan programs' high anticipated burden represent a continued barrier to access, relative to the risk-mitigating structure of PIF;
 - b. A loan program maintains the old paradigm of a “public system...managed to sustain institutions.”
5. PIF can catalyze a renewed public investment in higher education, developing the political traction for increasing investments from the general fund, adding to this the ever-increasing PIF contributions, and enabling would-not-have-been students to enter higher education and graduate. That is, PIF presents a key to achieving 40-40-20,
 - a. A loan program legitimizes the current system of gradually or steeply defunding public higher education.
6. PIF creates an engaged, contributing and generationally strong community of stakeholders in higher education who are, literally, stakeholders for the next generation, enabling access and education for their own children.
 - a. A loan program accepts students in higher education as a passive and transient constituency, with little political power.

On the second question, it's unclear how critical it is politically that only a fully self-sustaining program could be piloted. But the sensitivity analysis section of this memo addressed one underlying issue that question alludes to, which is "How great is the risk of the pilot not recovering its initial cost, and to what extent can mid-stream pilot design changes mitigate that risk?"

Finally, in light of the exclusion of PIF from the HECC agency budget, there is one remaining critical question: “How can the initial investment for funding PIF be met?”.

Although the program is projected to become self-sustaining, initial financing for the “Pay it Forward” (PIF) must be provided for by the Legislative Assembly. One advantage to financing PIF is that as a self-sustaining program, the pilot itself can be established with a one-time appropriation, rather than necessitating ongoing biennial requests. Options include:

1. Lottery bond proceeds: Using bond proceeds makes sense if the program does not expect to make an ongoing request for funds each biennium. Lottery bond proceeds are set aside for economic development purposes (for which PIF qualifies) and therefore face a narrower demand.

2. Article XI-R bond proceeds: If Measure 86 passes in November, the Legislature will have the option to issue Article XI-R bonds and deposit those proceeds into the Student Opportunity Fund. It would be permissible for those proceeds to be invested through the PIF program, with any declared earnings either cycled back into the PIF investment or simply converted to direct grants. Issuance of XI-R bonds would compete against most other general obligation bonding capacity, but capacity is expected to be much larger than that of Lottery bonds.
3. General fund appropriations: The Legislature could simply appropriate sufficient moneys out of the state's General Fund in order to finance the program. Although this is the simplest and most direct source of funds, it presents challenges as the request would functionally compete against many other programs.

Further, it would be a simple matter to establish an operations account for PIF that was able to accept private donations as well as public appropriations, in the event that a third party was able to make a contribution to the pilot program.

The work group recommends that the Higher Education Coordinating Commission endorse the Pay It Forward pilot proposal and forward it to the Legislature for its consideration and determination of an appropriate funding source.

Thank you.

Rob Fullmer
HECC PIF Workgroup Chair