Date of Hearing: March 19, 2019

ASSEMBLY COMMITTEE ON HIGHER EDUCATION
Jose Medina, Chair
AB 154 (Voepel) – As Introduced January 7, 2019

SUBJECT: Public postsecondary education: income share agreement: pilot program

SUMMARY: Requires establishment of an income share agreement (ISA) pilot program at one campus each of the University of California (UC) and the California State University (CSU), contingent on funding for this purpose. Specifically, **this bill, as proposed to be amended**:

1) Requires UC and CSU to select one of their respective campuses to establish a pilot program in 2021-22 to provide funds for students who enter into ISAs with the campus.

2) States legislative intent that the pilot program be targeted to students for whom ISAs could provide a feasible alternative to using loans to pay for a portion of their costs of college attendance.

3) Defines "income share agreement" as one between the campus and a student under which the student commits to pay a specified percentage of the student's future income, for a specified period of time, in exchange for payments to or on behalf of the student for a portion of the costs of his or her postsecondary education.

4) Stipulates that an ISA shall include all of the following:

   a) Require monthly payments, of a specified percentage of the student's annual income for a specified period of repayment not to exceed 10 years, and specifies that the period of repayment begins six months after the student is no longer enrolled in an accredited college program;

   b) Not require any monthly payment for the period of time the student's annual income is below $20,000;

   c) Provide that the payment specified in (a) may be extended by the number of years equal to the number of years during which the agreement is in force for which the student's annual income is below the amount specified in (b), but in no case shall be extended for longer than a total of 60 months;

   d) Specify the definition of income to be used for purposes of calculating a student's obligation under the contract. (Income for this purpose, shall not include income from a spouse, inheritance, legal settlements, or disability income.);

   e) Specify the terms and conditions by which the student may extinguish their obligation under the ISA before the end of the repayment period; and,

   f) Specify a cap on the amount that a student will ever have to pay under the agreement.

5) Provides that an ISA is not in compliance with this statute unless the student, prior to entering into the ISA, is provided a disclosure document clearly stating all of the following:

a) That the ISA is not a debt instrument, and that the amount the student will be required to pay under the agreement may be more or less than the amount provided to the student and will vary in proportion to the student's future income;

b) That the obligations of the student under the ISA may not be dischargeable in bankruptcy law;

c) Under what terms the student's obligations under the agreement may be extinguished by accelerating payments;

d) The duration of the student's obligation under the agreement, included any circumstances under which the contract would be extended;

e) The percentage of the student's future income that the student is committing to pay under the ISA and the minimum amount of annual income that triggers the student's obligation under the agreement to make payments; and,

f) The definition of income to be used for purposes of calculating the student's obligation.

6) Authorizes UC or CSU to impose additional terms or requirements for the program that are not inconsistent with the above.

7) Stipulates that the campus may not exert any authority over a student's selection of a baccalaureate degree program based solely on the student's participation in the pilot program.

8) States legislative intent that students approved to participate in the pilot program be enrolled in a wide variety of baccalaureate degree programs.

9) Stipulates that students in their sophomore, junior, or senior year are eligible to participate in the pilot program.

10) Authorizes UC or CSU to impose other eligibility requirements and cap the number of participants based on the moneys appropriated for the program.

11) Makes implementation of the ISA pilot contingent on an appropriation of funds for this purpose.

12) Provides that monies appropriated for the program shall be placed in an Income Share Agreement Revolving Fund, to be administered by the participating UC and CSU campus, respectively, and shall be used to provide funds to students who enter into ISAs. Payments made by graduates pursuant to an ISA shall be deposited into the revolving fund to be used by the campus to enter into additional ISAs. Allows campuses to use up to five percent of moneys annually deposited into the revolving fund for administration of the pilot program.

13) Requires the participating campuses to report specified information about the program to the Legislature by November 1, 2023 and again by November 1, 2026.

EXISTING LAW: Establishes the Middle Class Scholarship Program to offset a portion of tuition costs at the UC and CSU for students with annual household incomes less than $150,000. (Education Code Section 70020, et seq.)

FISCAL EFFECT: According the Assembly Appropriations Committee analysis of an identical bill in 2018:

1) Annual GF costs, likely in the low millions of dollars, to support ISA pilot program. ($1 million dollars annually would support living expenses of $10,000 for 100 students.) Over time, the program could become self-supporting if universities collected sufficient participant income.

2) One-time GF cost pressures in the high tens of thousands of dollars to develop the ISA program at UC. (The bill allows campuses to use a portion of ISA funding to pay administrative costs. ISA funding would initially be GF, until students began paying the funds back after graduation.)

3) Annual GF cost pressures in the low hundreds of thousands of dollars for UC to hire a full-time staff person, develop information for reports, and manage the program and to require legal counsel to draft legally enforceable agreements. (The bill allows campuses to use a portion of ISA funding to pay administrative costs. ISA funding would initially be GF, until students began paying the funds back after graduation.)

4) One-time GF cost pressures in the high tens of thousands of dollars to develop the ISA program at UC. (The bill allows campuses to use a portion of ISA funding to pay administrative costs. ISA funding would initially be GF, until students began paying the funds back after graduation.)

5) Annual GF cost pressures in the low hundreds of thousands of dollars for CSU to hire a full-time staff person, develop information for reports, and manage the program and to require legal counsel to draft legally enforceable agreements. (The bill allows campuses to use a portion of ISA funding to pay administrative costs. ISA funding would initially be GF, until students began paying the funds back after graduation.)

COMMENTS: *Background.* An Income Share Agreement is a contract in which a person agrees to pay a fixed percentage of their income for a defined length of time, in exchange for up-front funding or services. (The general concept of an ISA was first developed by economist Milton Freedman in the 1950s.) In higher education, this contract is typically between a student and an institution. An ISA differs from a loan in how the amount owed is calculated. In a loan, the individual makes payments based on an interest rate until their principal balance is reduced to zero. With an ISA, the individual pays a percentage of their income for a set period of time, regardless of the total amount paid. There is no outstanding "balance."

ISAs thus offer an alternative to debt. Debt creates substantial risks to students if they cannot afford their payments after college, whereas ISA payments adjust according to levels of income. In addition, ISAs typically have a minimum income threshold and a maximum payment cap, so students will not pay if they do not meet a minimum income level, while those earning a substantial income will not pay more than a certain maximum amount.

An ISA differs from a traditional loan in that students aren't accruing interest on the total amount funded through the ISA. Most individuals entering into an ISA, however, will pay more than the principal amount borrowed. The amount required to pay (the Income Share percentage multiplied by earned income) only grows due to the growth in earned income. The income share percentage level does not change over the course of the ISA repayment.

While ISAs have been provided by investors to individuals, only a few colleges have implemented an ISA program. The largest and most well-known program is Purdue University's "Back a Boiler," which to date has been funded by the university's foundation. (Purdue's mascot is the Boilermaker.) The program, which began in 2016, has provided $9.5 million in ISAs to almost 760 Purdue students, representing 120 unique academic majors. The program was limited to junior and seniors in its first year and was expanded to include sophomores in its second year.

Purdue's program is intended not to replace grants, scholarships, or government-subsidized student loans, but rather is an option for students who might otherwise take out private loans or federal Parent Plus loans, each of which carry higher interest rates than subsidized loans. The Back a Boiler website includes a comparison tool allowing a student to compare the potential monthly and total costs of an ISA with a PLUS loan and private loan of the same principal amount. (https://purdue.edu/backaboiler/comparison/index.html) This tool also models an ISA, based on the amount of the ISA and the student's major and expected graduation date. This translates to assumptions about the student's expected income upon graduation and subsequent income growth, and results in an income share percentage that the student would have to pay and a time period of repayment.

For example, according to the model, a civil engineer graduating in June 2019 is projected to have an income of $54,000 upon graduation and that income is assumed to grow by 3.8% annually on average. If this student accepted an ISA of $10,000, they would pay 3.03% of their income for the first 96 months following graduation. (All ISAs have a six month grace period before payments begin and the repayment period is typically between 9 and 10 years.) Conversely, a history major graduating at the same time is projected to have an income of $37,000 upon graduation. For a $10,000 ISA, this student would pay 3.92% of their income for 112 months following graduation.

Other elements of the Purdue program include a minimum income under which a graduate does not have to make ISA payments and an absolute cap of 2.5 times the ISA amount that a graduate would ever have to pay.

Purpose. The author notes the increasing debt that students are assuming upon graduation. Nationwide, student loan debt totaled over $1.2 trillion in 2015, an increase of over 250% since 2004. Average student loan debt for recent graduates of California institutions is almost $23,000. The author proposes to giving students another option to financing a portion of their higher education through private loans by authorizing an ISA pilot program at one UC and CSU campus, respectively.

AB 154 encompasses many of the parameters of the "Back a Boiler" program. It establishes a minimum income threshold for requiring ISA repayment and requires a limit on the repayment period, a six-month grace period, and an absolute cap on the amount that would be repaid. The bill also contains consumer protection provisions, by requiring that specified terms and conditions of an ISA be fully disclosed to a student prior to their entering into an ISA.

The bill also establishes a revolving fund at the participating campuses. Appropriated funds would be deposited into the revolving fund for the initial ISAs, and graduates' subsequent ISA payments would be deposited into the fund to provide ISAs for additional students. The participating campuses would report twice to the Legislature on the results of the pilot program.

Amendments. The author has agreed to the following clarifying amendments:

1) The first amendment would clarify that a student would not have to make payments on the ISA while they are enrolled full-time in an undergraduate, graduate or post-graduate program. On page 3, lines 3-4:

    The period of repayment shall commence six months after the ~~*student's graduation*~~ *student is no longer enrolled full-time in an accredited college program*.

2) The second amendment would provide that the ISA repayment period, even though it may be extended by the number of years the graduate's income is below $20,000, cannot be extended more than five years. On page 3, lines 9-13:

    (C) It shall provide that the period of repayment determined pursuant to subparagraph (A) may be extended by ~~*the number of years equal to*~~ the number of years the agreement is in force for which the student's annual income is below twenty thousand dollars ($20,000), *but in no case shall the period of repayment be extended for longer than a total of 60 months*.

3) The third amendment would require that the definition of "income," which is used to calculate the student's repayment, would have specific exclusions. This is because the goal of an ISA is for payments to reflect the "return on investment" in the student's education, i.e. their salary, and not other sources of income. On page 3, line 16, add:

    For purposes of this section, "income" shall not include income from a spouse, an inheritance, or a legal settlement, or disability income, or income from another source as determined by the participating campus.

Opposition. The California Faculty Association (CFA) is concerned that the bill creates "a long-term burden and mandatory garnishment of wages for every graduate once they enter the workforce.

The criticism appears not to take into account the ISAs are chiefly meant to be an alternative to students taking out private student loans, which can create an even greater financial burden for recent graduates. Moreover, there does not seem to be anything preventing a UC or CSU campus from establishing their own ISA program today, using moneys given to the campus and available for that purpose. AB 154 would use state funds for a pilot program only and be subject to all the requirements specified in the bill.

Prior Legislation. This bill is almost identical to AB 2479 (Voepel) of 2018, which passed the Assembly 77-0 and was subsequently held on Suspense in Senate Appropriations.

REGISTERED SUPPORT / OPPOSITION:

Support

13th Avenue Funding

Opposition

California Faculty Association
Faculty Association of California Community Colleges

Analysis Prepared by: Chuck Nicol / HIGHER ED. / (916) 319-3960