BACKING THE FUTURE

Purdue Ponders Innovative Funding Initiative

By Matt Ottinger

The problem – soaring college debt to the tune of $1.2 trillion nationally – is clearly identified. The solutions, however, are far more elusive with one presidential candidate even pushing free public college for all.

While that may never be possible – or even practical – mitigating the debt tsunami has become a focus at Purdue University. The school's president, former Gov. Mitch Daniels, and the Purdue Research Foundation believe income share agreements (ISAs) could play a role in remedying the situation.

An income share agreement is not technically a loan, as there is no principal balance or interest. Rather, it is a loan alternative in which a student agrees to pay an investor a percentage of his/her salary for a defined amount of time after graduation in exchange for funds to help pay for school.

"If you break it down, it's sort of like a combination of a loan and an insurance policy," explains Beth Akers, a fellow in the Brookings Institution's Center on Children and Families and the Brown Center on Education Policy. "It's a loan in that it's allowing students to borrow money from their future selves, and an insurance policy because if it turns out the students don't do well financially, they're not on the hook anymore for that liability. It's the insurance piece that I think is the necessary innovation at this point."

Back a Boiler

Purdue's potential ISA program is titled "Back a Boiler."

"The motivation to explore an ISA was to determine if an alternative could exist to the private loans and Parent PLUS loans that some Purdue students need to take out to help pay for their education over what they are able to get from government loans or scholarships," reveals Brian Edelman, Purdue Research Foundation CFO and treasurer. "The intent is that this type of educational funding resource would be a supplement to a government loan or scholarships."

Purdue enlisted Vemo Education, which designs and implements traditional debt alternative programs for colleges and universities, among other advisors in the process.

"We think the student debt crisis at its root isn't one of debt, but of value," remarks Vemo Education CEO Tonio DeSorrento. "If you look at a student loan, whether it's from a private lender or the federal government, on its face it's not necessarily onerous or unjust, it's just that the relationship it creates between the students and the provider of finance – it doesn't align them all."

Investing structures can include pooling arrangements, although DeSorrento believes the largest investors will initially be the schools themselves. He adds that some competency-based coding academies currently use ISAs, and he thinks more colleges will employ them as a component of tuition.

"If we proceed, the foundation will form a fund that will be the investor into a pool of the ISAs with our students," Edelman details. "If

Purdue University has long been one of Indiana's most valuable assets when it comes to educating future leaders. School officials are working to minimize the debt those students may face after graduation.

we are successful, over time we anticipate we could have outside investors who are seeking return on their capital who would become a part of that fund. They could buy down the position initially taken by the foundation. But the foundation will initially be the primary issuer of the ISAs."

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ISAs in action

While ISAs have been used in other countries, there may be little to learn from that, according to Akers.

"We've seen them used in the private market in some South American countries," she observes. "It's a really small scale and they have a dramatically different system of higher education finance there. So I'm not sure how many of the lessons are applicable here."

She also notes Yale University attempted a version of the ISA (in the 1970s), "and it didn't work out particularly well, but there were some differences in how that program was arranged."

And while the potential savings and financial benefits for students will be revealed in time, Akers contends a potential benefit for ISAs is a psychological one.

"In general, people are happier when they have less risk," she points out. "The innovation of the ISA allows for mitigation of more risk, so it's natural there would be a preference for that product over a loan product. However, there's a cost. Just like other insurance policies, there will be a premium built in for that insurance. So do people still favor a financial product that has an insurance component, or do they prefer a straight loan? It's really an open question."

Another potential benefit, Edelman shares, is that an ISA can be extended to many students and "does not focus at all on the student's zip code or the family's assets."

"What it focuses on is the expected future fruits of the student's labor, and that focus of how the decision is made to extend the agreement will open up this financing source to many students from many types of backgrounds," he elaborates. "Many people who write policy thoughts on this topic do believe the hypothetical first-generation college students may need to borrow from private loans or Parent PLUS loans, and those students could value the downside protection on the income outcomes (used in ISAs) post-graduation."

Getting critical

One critic, former White House education advisor (under President Obama) David Bergeron, tells *The Wall Street Journal*, "It feels icky to me." He contends ISAs could become predatory or undermine the federal financial aid system. DeSorrento, however, rebukes that sentiment and believes the administration actually favors this concept in the broad sense.

"ISAs are a progressive idea," he states. "If you look at how the Obama administration has reshaped federal student lending, this idea has completely won there. They've moved to Pay As You Earn (PAYE) as their favored payment plan for student loans on the federal level, so the Obama administration has endorsed it. We do it without a government subsidy or government involvement, so it's a private sector thing that people can opt into."

It's also been argued that ISAs embody a form of indentured servitude or they could push students toward STEM fields with higher earning potential – potentially neglecting arts and other courses of study. Edelman understands the contention, but believes "it's predicated on a false economy."

"What we're really talking about is replacing a portion of that capital that has financed a student's education with an ISA," he asserts. "That allows that lower income-expecting graduate a buffer so if they have an event happen in life or if their earnings are below expected levels, it provides a very different financial instrument to be part of the capital used to finance their education. So the false economy people jump to when they believe ISAs might create some dystopian social engineering at a university is where I think they don't understand the actual economics of the existing financing of an education."

Moving forward

ISA advocates are currently supporting attempts at government regulation. Indiana Congressman Todd Young has proposed legislation to clarify the tax treatment for students and put in place robust consumer protections.

"I think having regulations at the federal level would be extremely helpful for the pilot program Purdue is contemplating," Edelman concludes. "It's unlikely we'll get such legislation in 2016, so one decision we'll have to make is if we're willing to proceed with our pilot without the guidance that would come from Rep. Young's legislation or other national legislative measures."

In a recent interview with the Indiana Chamber (see more on Page 16), Daniels says the potential for ISAs is "exciting," and he's eager to see if the market demands such a funding mechanism.

"It could be fascinating too if it got to some sort of scale," Daniels asserts. "You would have, in essence, portfolios of students … the low risk of an electrical engineer not being able to meet the obligation could be merged with the possible high risk the philosophy or theater major might seem to incur. We will try to get the program on offer as early as March 2016 – and start to find out."

RESOURCES: Beth Akers, Brookings Institution, at www.brookings.edu | Brian Edelman, Purdue Research Foundation, at www.prf.org | Tonio DeSorrento, Vemo Education, at www.vemo.com