ISSUE BRIEF

APRIL 2008

THE PROJECT ON STUDENT DEBT

# DENIED Community College Students Lack Access to Affordable Loans

If you need to take out a loan for college, it is tough to find a better deal than a federal student loan.[1] The interest rate is low and fixed, fees are minimal, and the federal government pays the interest for the majority of recipients while they are still in school, or even after students graduate if they become unemployed or face other economic distress. Starting next year, the loan payments for virtually all types of federal loans to students past and present can be capped at an affordable amount based on the borrower's income and family size.

Perhaps the most important feature of federal student loans is that they are offered to students regardless of their income or credit history. With college costs rising faster than grant aid, the federal student loan programs can help fill the gap with reasonably priced financing for almost every college student.

But students cannot get a federal student loan if the school they attend does not participate in the federal loan program. While almost all four-year colleges and universities in the country do participate, an alarming number of community colleges – where lower income and minority students are most likely to attend – do not.[2]

More than one million students are enrolled at community colleges that have opted out of the federal student loan program. In 13 states, more than 10 percent of community college students do not have access to federal loans. In eight states, more than 20 percent cannot get a federal loan. These students must resort to riskier, more expensive forms of debt, such as credit cards or private student loans, when they need help bridging the gap between available grant aid and college costs.

| Highest Proportions of Community College Students Without Access to Federal Loans | |
|---|---|
| Georgia | 60% |
| Alabama | 51% |
| North Carolina | 47% |
| Louisiana | 47% |
| Montana | 27% |
| Virginia | 24% |
| Tennessee | 22% |
| Utah | 20% |

Note: For full list see chart on page 7.

African Americans and Native Americans are much less likely to have access to federal loans than other community college students. Nationally, 20 percent of African-American community college students and 19 percent of Native-American students are unable to take out federal student loans, compared with nine percent of White students. The same is true of 11 percent of Latino students at community colleges and five percent of Asian-American students.

Our discussions with non-participating colleges revealed some reasons why they opt out of the federal loan program. Most common is a concern that students might default on their loans, which could cause the college to face sanctions that threaten its ability to disburse federal aid in the future. Our analysis indicates that this risk is much more manageable than is commonly assumed, and does not justify denying all students at a college access to federal loans.

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[1] For the purposes of this issue brief, we looked at the Federal Stafford Loan program, including loans made or guaranteed by the federal government and those administered by private companies and/or state agencies but insured or reinsured by the federal government. Other federal loans include Perkins, PLUS, Grad PLUS, and consolidation.

[2] We use the term "community colleges" to refer to public two-year institutions which, as classified by the federal government, include colleges that focus on preparing students to transfer to four-year colleges, as well as technical colleges that provide vocational certificates for particular careers at the undergraduate level. These institutions also serve adults with continuing and basic skills education.

## Largest Gaps in Federal Loan Access Between Racial and Ethnic Groups

| State | The Details | Gap |
|---|---|---|
| Montana | 95% of White community college students can get federal loans, while only 8% of **Native-American** students have access. | 87 |
| North Dakota | Nearly all White community college students can get federal loans, while only 37% of **Native-American** students have access. | 63 |
| Tennessee | 87% of White community college students can get federal loans, while only 45% of **African-American** students have access | 42 |
| Arizona | 98% of Latino community college students can get federal loans, while only 65% of **Native-American** students have access. | 33 |
| Alabama | Only 56% of White community college students can get federal loans, and only 30% of **African-American** students have access. | 26 |
| Virginia | 95% of Asian American students can get federal loans, while only 72% of **White** students have access. | 23 |
| New Jersey | 98% of White community college students can get federal loans, while only 78% of **African-American** students have access. | 21 |
| Utah | 82% of White community college students can get federal loans, while only 62% of **Latino** students have access. | 20 |
| Illinois | 91% of White community college students can get federal loans, while only 71% of **African-American** students and 75% of **Latino** students have access. | 20 |

## Native-American Students and Tribal Colleges

Only a few states have community college enrollments that include a high enough percentage of Native-American students to develop a clear understanding of their access to federal loans. In most of these states we found large gaps in access between Native Americans and other students.

In states with larger Native American populations, these students are more likely to attend Tribal Colleges and Universities (TCUs). In general, TCUs do not participate in the federal student loan programs, leading to a disproportionate lack of federal student loan access for Native-American students nationally. Poverty and high unemployment rates on Indian reservations may lead administrators to worry about students' prospects for loan repayment, but the unemployment rates of TCU graduates are much lower than on reservations generally.* Additionally, federal student loan borrowers are protected during periods of unemployment – unlike those who use private loans or credit cards to cover college costs. While Native Americans may have a different economic profile and often attend different types of institutions than other college students, they should still have access to the safest, most affordable borrowing options for college.

*American Indian College Fund, undated.

## Who Goes to Community Colleges, and What it Costs

Nationally, community colleges educate more than 40 percent of all undergraduate college students, including more African-American, Latino, and low-income students than any other type of college. Typically described as "open admission" or "open enrollment," community colleges provide widespread access to postsecondary education and vocational training for students of all ages. In addition to facilitating student transfers to baccalaureate-granting institutions, community colleges provide myriad services including vocational training, workforce development, and lifelong learning opportunities.

Community colleges also tend to be easier to get to and have simpler admissions criteria, broader course offerings, and lower tuition and fees than other college options. Because of the low tuition, community colleges are often considered the most affordable option for higher education. While this may be true, the total costs of being a student extend far beyond tuition and fees, including textbooks and supplies, transportation to and from the campus, housing, food, and other personal expenses – all of the same costs faced by students at other colleges.

In part because community college students are less likely to consider these costs in their entirety when budgeting for college, they are less likely to apply for and receive financial aid. Many students have full-time jobs that enable them to absorb the extra costs of one or two courses per term. However, full-time jobs also compete with academic study: students taking one or two courses per term while maintaining a full workload are significantly less likely to achieve their academic goals.[3] For these students, a transportation breakdown or childcare emergency can compromise their ability to get to class. Many community college financial aid administrators have attested to the serious impact these types of financial emergencies can have on the lives and academic success of their students.

Financial aid, including loans, plays an important role in keeping community college students in college and on track. Even modest amounts can relieve financial pressures, allowing students to work less, or to have a financial cushion when an emergency would otherwise

[3] The negative effects of full-time employment and part-time enrollment on student success are both well documented. See King, 2002 and Chen, 2007.

| Loan Terms and Benefits for 2008-09 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 the federal loan program. | Any student enrolled at least half time; no credit check; college must participate in the federal loan program. | Enrollment requirements vary; borrower must be creditworthy or have a cosigner |
| **Amount** | $3,500 for freshmen, $4,500 for sophomores | For dependent students, up to subsidized amounts; for independent students, $7,500 for freshman and $8,500 for sophomores (minus any subsidized Stafford loan amount) | Most available for up to cost of attendance minus other aid |
| **Interest Rate** | Fixed at 6% maximum | Fixed at 6.8% maximum | Variable, no maximum; based on credit and market rates; up to 19% or more |
| **Fees** | Up to 2% | Up to 2% | Up to 11% |
| **Charges during school** | None | Interest accrues | Interest accrues or payments due |
| **Income-based repayment** | Available | Available | Not Available |
| **Economic hardship policy** | No payments required and no interest charged for three years of economic hardship | No payments required but interest accrues for three years of economic hardship | Lender discretion; usually very limited, and interest accrues. |
| **Policy during unemployment** | No payments required and no interest charged for three years of unemployment | No payments required but interest accrues for three years of unemployment | Lender discretion; usually very limited, and interest accrues. |
| **Public service forgiveness** | Various provisions for teachers, government and nonprofit workers | Various provisions for teachers, government and nonprofit workers | None |
| **Other cancellations** | Death or permanent disability; closed school | Death or permanent disability; closed school | None |

jeopardize their course of study. Community college students are most likely to succeed when given a full range of financial aid options, along with the counseling needed to make informed decisions.

## Examining Participation Choices

### Fear of Defaults

In the early 1990s, default rates on federal student loans were scandalously high, particularly at fly-by-night trade schools and career colleges. Congress passed tough sanctions on schools with very high default rates in an effort to increase institutional responsibility, protect students, and minimize scandal. As a result, it appears that many non-participating colleges stay out of the federal loan programs altogether to avoid the possibility of being sanctioned, which can mean losing the ability to disburse grant aid as well as loans.

A borrower is in default on a federal loan after making no payments for 270 days. The "cohort default rate" measures how many borrowers default on their loans in their first two years of repayment.[4] Colleges with cohort default rates above 25% for three consecutive years lose the ability to disburse federal Pell Grants, the largest source of grant aid to students. This is disastrous for students and colleges, since they both rely on the grants to cover costs. If a college has a cohort default rate above 40% in any one year, it will lose the ability to participate in the federal loan programs, but remain able to disburse Pell Grants. (See sidebar on next page for more details about the cohort default rate and institutional sanctions.)

While we did not conduct a formal poll of non-participating colleges, our discussions with some of them indicate that their reasons for denying students access to federal loans are fairly consistent. The most pressing is a fear of sanctions, and of losing access to Pell Grants in particular.

We have reviewed institutional cohort default rates, sanction regulations, and appeal options in detail, and *we cannot find any reason that any community college would*

[4] In this brief, we use the terms "default rate" and "cohort default rate" interchangeably.

## Cohort Default Rates 101

### What is default?

A borrower defaults on their federal student loan after not making any payment for 270 days. This can only occur after a student graduates or is no longer enrolled in college at least half-time, and after a six-month grace period between the end of school and the start of repayment.

### What is the cohort default rate?

The cohort default rate measures the numbers of borrowers from a given class who default within two years of entering repayment. For the majority of institutions, cohort default rates are calculated using the equation:

# of borrowers who entered repayment in 2005, and defaulted in 2005 or 2006 ÷ # of borrowers who entered repayment in 2005 = 2005 Cohort Default Rate

Institutions with a very small number of borrowers (fewer than 30 entering repayment in a year) use a modified calculation that determines average rates over three years. This minimizes large fluctuations in cohort default rates due to a small number of borrowers.

### Why do default rates matter?

Institutions with high default rates may face sanctions that impact the institution's future ability to disburse aid to students.

| Default Rate | Sanction |
|---|---|
| 25% or higher in three consecutive years | Loss of Stafford loan eligibility and Pell Grant eligibility for three years |
| 40% or higher in one year | Loss of Stafford loan eligibility for three years |

### How frequently do institutions lose Pell Grant eligibility because of default rates?

No institution – community college or otherwise – has lost Pell Grant access due to default rates since 2004, when one school was sanctioned (Walsh and Dozier, 2008).

*be in jeopardy of losing Pell Grants by participating in the federal loan program.* Only one community college in the country had a 2005 cohort default rate over 25 percent, and its 2004 rate was much lower.[5] This college would only stand to lose Pell Grant eligibility after three consecutive years of default rates at its 2005 level.

[5] The 2005 cohort default rates are the most recent available.

## Cohort Default Rate Appeals

Once institutions are notified of their initial calculated cohort default rate, they can challenge, adjust, or appeal the calculated rate if it was based on inaccurate or misleading data. However, resource-strapped public colleges are less likely to devote staff time to this process than for-profit trade schools and career colleges. Of the 19 colleges on the Department of Education's list of colleges that have had 2005 default rates changed due to adjustments or appeals, 18 are for-profit institutions.

Institutions can also appeal potential default rate sanctions based on exceptional mitigating circumstances. These include serving predominately low-income students and having just a few students borrowing each year. Details about these appeal types can be found in the Cohort Default Rate Guide published by the Department of Education's Default Prevention and Management department. The Department does not keep records of the number or types of challenges, adjustments, or appeals requested by institutions.

One appeal in particular – the *participation rate index appeal* – holds particular promise for community colleges that may find themselves with high default rates (see inset above). We estimate that *70 percent* of currently participating community colleges would be eligible to file a participation rate index appeal if their default rates rise.

If any institution does find itself with sanction-level default rates, it may be able to appeal those rates. In the case of community colleges, there is a good chance that a high rate would be the result of a small number of borrowers, or a small percentage of students at the college taking out loans.[6] The Department of Education's regulations do take these situations into consideration by providing a number of appeal options, and institutions that successfully appeal may be exempted from sanctions (see sidebar above).

One type of appeal holds significant potential for helping community colleges that struggle with default rates. The "participation rate index" appeal can raise the default rate threshold that triggers sanctions. We estimate that the majority of community colleges have loan participation rates – the share of students eligible to borrow who choose to do so – that meet the criteria for such an appeal.

While the available appeals should help assuage fears about the risks of participating in the federal loan programs, the reality is that very few community colleges have faced sanction-level default rates in recent years.

[6] At participating colleges, the extent to which financial aid offices make information about loan options available to students varies, and can depress participation rates. See *Green Lights and Red Tape* (The Institute for College Access & Success, 2007) for discussion on this topic.

## Participation Rate Index, by the Numbers

An institution's federal student loan participation rate is the share of its students who are eligible to borrow that do borrow federal loans. The participation rate *index* is the participation rate multiplied by the institution's default rate. An institution where only 10 percent of eligible students actually borrow would have to experience a default rate as high as 37.5 percent (instead of 25 percent) for three years, or over 60 percent in one year, before sanctions could be imposed.

To appeal sanctions based on a 25 percent or higher default rate, the participation rate index must be 0.0375 or less. To appeal sanctions based on a 40 percent or higher rate, the index must be 0.06015 or less. Here are some examples:

College A has 2,500 students who are eligible to borrow federal loans, and 250 borrowers. The college's most recent default rate is 35 percent.

250/2,500 x .35 = 0.035

College A could appeal based on its participation rate index.

College B has 6,000 eligible students, 750 borrowers, and a default rate of 45 percent.

750/6,000 x .45 = 0.05625

College B could appeal based on its participation rate index.

*Any college with less than 15 percent of eligible students borrowing has a participation rate low enough to be given leeway in the 25 and 40 percent default rate thresholds.* We estimate that, of currently participating community colleges, 70 percent could take advantage of this flexibility if default rates become an issue.

Default management techniques – such as entrance and exit counseling that includes financial literacy, counseling for at-risk students, and mindfulness of when students are no longer enrolled – are effective and practical in today's technology-driven financial aid office.

In fact, most community colleges with previously high default rates have managed to lower them using these and other targeted approaches. In 1990, there were 252 community colleges with default rates of 20 percent or more. Some left the federal loan program, but 80 percent stayed and remain current participants. The most recent average default rate for the remaining 212 colleges is less than 10 percent, and only one of these institutions has a default rate above 20 percent (and it is only slightly higher at 20.5 percent). [7]

## Protecting Students From Debt

The other explanation colleges sometimes give for non-participation in federal loan programs is a belief that students – either the entire student body or a certain fraction – should not borrow for a community college education. To prevent unnecessary borrowing and protect students and the school from risk, a college may decide to prohibit all borrowing by not participating in the federal loan programs. This desire to shield students from debt, while admirable, is not wholly realistic in light of rising costs and stagnating grant levels. When students have trouble making ends meet, federal loans are much less risky than their other borrowing options: using a credit card or taking out a private student loan.

Still, some non-participating community colleges steer students interested in borrowing towards costly private loans. We found a number of college websites that state their non-participation in federal loan programs, but then refer students to private lenders (see examples). If mitigating the risks of student debt is a factor in institutional decisions about loan program participation, colleges should not steer students toward riskier alternatives. Hawaii Community College, a participating college, takes a different approach. The college describes its loan philosophy on its web site, followed by information on applying for federal loans:

> "While Hawaii Community College believes that student loans are an integral part of the federal aid programs, we are deeply concerned about student loan default and high student loan indebtedness. Therefore, whenever possible we will encourage students to select work-study or off-campus employment instead of student loans. In addition, we will encourage students to borrow as little as possible at the community college level – where educational costs are lower than at four-year colleges and universities."[8]

In the case of individual students whom colleges consider at high risk of defaulting, financial aid administrators do have some discretion to deny federal loans to individual students. If administrators are unable to dissuade these students from borrowing with counseling and advice, they have the authority to make *professional judgments* (adjustments to a student's aid eligibility), when extenuating circumstances call for a deviation from the standard procedure. One explicit use of professional judgment is to deny loans to individual students who are considered high-risk. As long as these adjustments do not amount to a pattern of discrimination, and administrators can document their reasons for making a change, there is no limit to this authority.

[7] US Department of Education, Federal Student Aid, Default Prevention and Management. Official cohort default rates back to 1990 are available for download at http://www.ifap.ed.gov/DefaultManagement/press.

[8] http://hawaii.hawaii.edu/financialaid/ApplyLoans.html. Accessed April 8, 2008.

| Myth | Reality |
|---|---|
| One bad year and our students will lose their Pell Grants. | Colleges can only lose access to Pell Grants after three consecutive years of high default rates. |
| Our default rate is over 10% – we're in trouble! | A college with a 10% default rate is far from any risk of sanction. |
| If we offer loans to some students, we'll have to give them to everyone. | Financial aid offices have the authority to deny federal loan eligibility on a case-by-case basis. |
| Our students are all high-risk, so won't be able to prevent a high default rate. | Default management strategies work. No community college that had a high default rate in 1990 is currently at risk of sanction. |
| Our default rate is skewed by our low number of borrowers. | The Department of Education protects institutions with low borrowing rates from unfair sanctions. |

## Conclusion and Recommendations

Federal student loans can be a critical piece of the financing puzzle for many college students. When federal, state, and institutional grants fall short of what they need to cover college-related costs, students should have the safest, most affordable borrowing options available to them. Colleges may not want students to borrow, but they cannot actually control student indebtedness by opting out of the federal student loan programs. Without other options, students with real financial need will either turn to risky, expensive borrowing through private student loans or credit cards, or give up on going to college. Colleges should be able to counsel interested students about loans and how to use them wisely, and guide them towards the best loan options. Responsible loan entrance and exit counseling – required for federal student loans – provide opportunities for teaching students about sound budgeting skills, their responsibilities as borrowers, and their options for loan repayment.

Helping students make smart borrowing decisions, rather than preemptively shutting them out of the federal loan program, will help protect both schools and students from risk. The fact that students from certain ethnic groups face less access to good borrowing options than do others underscores the need for non-participating colleges to reconsider their policies and the impact on students. All degree-seeking college students who are enrolled at least half-time should be able to access federal student loans, regardless of their choice of institution or race or ethnicity.

### To ensure equal access to federal student loans:

- Non-participating community colleges should reconsider their decision to block student access to federal loans. A responsible default management plan, combined with income-based repayment options, make federal loans relatively safe for both schools and students.
- The Department of Education should publish an asterisk along with or instead of the official cohort default rates when an institution has successfully appealed its calculated rate. While institutions are not punished for deceptively high rates, the *appearance* of a high rate can raise unnecessary concern.
- The Department of Education should publish information about federal student loan participation by institution on a regular basis, and at least every three years.

## Methodology

The U.S. Department of Education does not maintain a list of institutions that do not participate in the federal loan program. To identify the non-participating colleges, we looked at data on federal loans made to students, by college, in the academic year 2004-2005. Colleges reporting this data only at the system or district level were excluded from this analysis, as were two-year campuses of state universities.

Any remaining institutions that had distributed any Stafford loans in 2004-05 were classified as participating. Those with no Stafford loan distribution were preliminarily classified as "non-participating." In these instances, we checked the college's website and called the financial aid office for confirmation.[9] For a small number of institutions, we received information that their participation status had changed since 2004-05, and we updated our data accordingly.[10] To assess the availability of federal student loans for different racial and ethnic groups, we multiplied each college's 12-month enrollment by the ethnic proportions of its students.[11]

At the end of this process, 254 of the 1,078 institutions on our list were categorized as 'non-participating' and 824 as 'participating.'[12] While all 1,078 institutions were included in the analysis, we eliminated Alaska and the District of

[9] We did not contact institutions designated as "participating" to confirm that they had not left the program. Our staff checked college web sites and called financial aid offices between March 19, 2008, and April 1, 2008.

[10] This reflects our knowledge of institutional participation as of April 1, 2008.

[11] College enrollment and racial and ethnic proportions are from the Integrated Postsecondary Education Data System (IPEDS).

[12] After excluding 49 central offices and branches as indicated above.

Columbia from the state data table (below), because less than five percent of their undergraduates attend public two-year colleges. From the race and ethnicity columns, we excluded participation rates for racial or ethnic groups that constituted less than five percent of the state's two-year public enrollment. See a list of all community colleges and their participation status.

**Share of Students Without Access to Federal Student Loans, by Ethnicity**

| State | Total Share Without Access | White | African American | Latino | Asian | Native American | Share of state's college students at community colleges |
|---|---|---|---|---|---|---|---|
| **Alabama** | **50.8%** | 43.5% | 70.0% | - | - | - | 36.0% |
| **Arizona** | **5.4%** | 4.5% | - | 2.4% | - | 35.7% | 49.1% |
| **Arkansas** | **7.5%** | 7.3% | 8.0% | - | - | - | 36.7% |
| **California** | **8.3%** | 7.4% | 11.2% | 11.6% | 3.5% | - | 65.8% |
| **Florida** | **7.7%** | 6.5% | 10.8% | 9.6% | - | - | 37.3% |
| **Georgia** | **60.1%** | 57.6% | 66.3% | - | - | - | 37.1% |
| **Illinois** | **14.3%** | 8.7% | 28.4% | 25.3% | - | - | 54.4% |
| **Kansas** | **0.2%** | 0.1% | 0.1% | 2.2% | - | - | 44.4% |
| **Louisiana** | **46.6%** | 50.5% | 41.9% | - | - | - | 23.8% |
| **Maryland** | **10.7%** | 7.9% | 18.5% | - | 3.4% | - | 47.1% |
| **Massachusetts** | **2.6%** | 0.3% | 14.5% | 4.9% | - | - | 26.0% |
| **Michigan** | **2.2%** | 2.1% | 2.2% | - | - | - | 39.9% |
| **Minnesota** | **0.2%** | 0.0% | 0.0% | - | - | - | 39.5% |
| **Mississippi** | **17.6%** | 11.3% | 27.0% | - | - | - | 50.4% |
| **Montana** | **27.3%** | 4.5% | - | - | - | 91.8% | 20.0% |
| **Nebraska** | **0.3%** | 0.0% | 0.2% | - | - | - | 39.2% |
| **New Jersey** | **6.6%** | 1.6% | 22.4% | 8.4% | 3.5% | - | 47.3% |
| **New Mexico** | **3.4%** | 1.6% | - | 1.3% | - | 17.5% | 56.0% |
| **New York** | **1.5%** | 0.1% | 2.7% | 7.1% | 0.6% | - | 29.8% |
| **North Carolina** | **47.2%** | 43.8% | 56.1% | - | - | - | 47.8% |
| **North Dakota** | **5.7%** | 0.4% | - | - | - | 63.2% | 21.2% |
| **Ohio** | **1.0%** | 1.2% | 0.4% | - | - | - | 34.4% |
| **Oklahoma** | **2.7%** | 2.8% | 1.3% | - | - | 3.7% | 36.1% |
| **South Carolina** | **4.2%** | 3.6% | 5.5% | - | - | - | 42.8% |
| **Texas** | **7.1%** | 6.5% | 5.1% | 9.9% | - | - | 52.4% |
| **Tennessee** | **21.7%** | 13.3% | 55.6% | - | - | - | 31.5% |
| **Utah** | **19.5%** | 18.1% | - | 37.9% | - | - | 19.6% |
| **Virginia** | **24.1%** | 28.1% | 19.7% | - | 5.2% | - | 42.6% |
| **Washington** | **13.2%** | 11.7% | 20.7% | 10.8% | 20.7% | - | 60.4% |
| **West Virginia** | **15.6%** | 14.8% | - | - | - | - | 18.4% |
| **Wisconsin** | **0.4%** | 0.1% | 0.1% | - | - | - | 39.3% |
| **United States** | **10.4%** | **8.6%** | **20.1%** | **10.7%** | **4.8%** | **19.2%** | 42.2% |

Notes: Excludes shares where ethnic group comprises less than 5% of state CC enrollment.
Excludes states where all community colleges participate in the loan program.

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**THE PROJECT ON STUDENT DEBT**

For Americans of all socio-economic backgrounds, borrowing has become a primary way to pay for higher education. The Project on Student Debt works to increase public understanding of this trend and the implications for our families, economy, and society. Recognizing that loans play a critical role in making college possible, the Project's goal is to identify cost-effective solutions that expand educational opportunity, protect family financial security, and advance economic competitiveness.


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