Senate Budget Committee on Education
Testimony of Diana Fuentes Michel, Executive Director
California Student Aid Commission

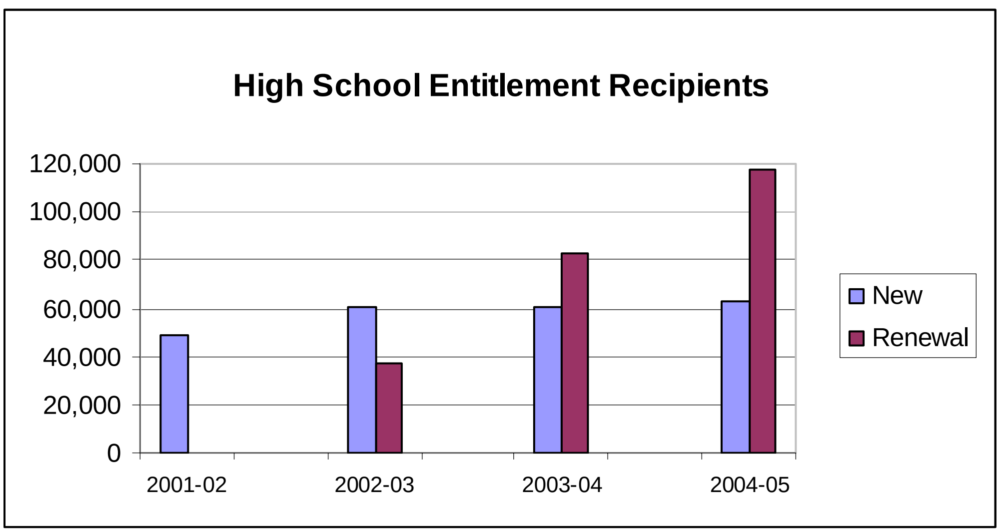
May 9, 2005 Committee Hearing

Good afternoon, I am Diana Fuentes Michel, Executive Director of the California Student Aid Commission. On behalf of the California Student Aid Commission, I would like to thank Chair Scott and the Committee for this opportunity to talk with you about the work we do at the Commission and some budget issues that deserve your consideration. The recommendations that come out of this committee will have a direct effect on our ability to continue to provide the Cal Grant and student loan aid so many California students depend on to help pay for their college education.

As you know, the Commission's mission is to make education beyond high school financially accessible to all Californians. Our priority, in the midst of this challenging fiscal environment continues to be to maintain the integrity and effectiveness of the Cal Grant and federal student loan programs we administer.

The Cal Grant Entitlement Program

The California Education Code (Section 66021.2) that was adopted (by unanimous vote) as part of the Ortiz-Pacheco-Poochigian-Vasconcellos Cal Grant Program (SB 1644, Chapter 403, Statutes of 2000) affirms the state's historic commitment to provide educational opportunity to students pursuing a higher education by ensuring access and choice for students with financial need and who meet academic criteria. Since the enactment of SB 1644 which established the Cal Grant Entitlement Program, the program has grown dramatically:



- The number of new Cal Grants awarded to graduating high school seniors increased by more than 30 percent from 48,417 in 2001-02 to 63,219 in 2004-05;
- The total number of new and renewal High School Entitlement recipients has nearly quadrupled to 181,051 in 2004-05; and

- The number of new California Community College Transfer Entitlement awards provided to recent high school graduates who successfully transfer from a community college to a California four-year, baccalaureate-granting college or university has increased more than seven fold from 560 in 2002-03 to 4,230 in 2004-05.

Projecting Cal Grant Awards and Costs for 2004-05 in the Governor's Budget

- The original projection of Cal Grant costs for the 2004-05 Governor's Budget was made in October 2003 amidst great uncertainty about the impact of accompanying proposals in that budget to reduce freshman admissions at the University of California and California State University by 10 percent, reduce the income ceiling for Cal Grant eligibility by 10 percent, not have Cal Grant awards cover fee increases at UC and CSU, and to cut the maximum grant at independent institutions by 44 percent.

- When revised projections were made for the final Budget passed at the end of July 2004, it was still unclear what the impact of rejecting most of these proposals would be on Cal Grant recipients' enrollment behavior, but a projected cost of $758.9 million was included in the final Budget.

- In October 2004, Cal Grant costs for the current year were revised based on the actual Cal Grant offers made to that point and on the enrollment decisions that new and renewal Cal Grant recipients appeared to be making. The resulting reassessment was a revised 2004-05 budget projection of $714.1 million.

- Over 96 percent of the $44.8 million difference between the 2004-05 budgeted and actual amount for the Cal Grant programs is attributable to fewer March Competitive recipients than anticipated renewing at four-year institutions and fewer renewals overall in the September Competitive program. Moreover, of the September Competitive recipients who did renew, a smaller percentage than expected had transferred to four-year institutions.

Governor's 2005-06 Budget Proposals:

<u>Maximum Award for UC and CSU Students:</u> We applaud the Governor's decision to maintain the integrity of Cal Grant awards for students choosing California's public universities by continuing the practice of increasing the maximum Cal Grant award for these students to fully cover increases in mandatory systemwide tuition and fees.

<u>Maximum Award for Private College and University Students:</u> Prior to 2000, California had a longstanding statutory policy that set and maintained the maximum Cal Grant award for students attending non-public institutions at the estimated average General Fund cost of educating a student at a public four-year institution. This cost-neutral formula was eliminated in 2000 with the enactment of SB 1644 and the maximum grant is now stipulated in the annual Budget Act.

The Governor's Budget proposes to reduce the maximum Cal Grant award for students attending non-public institutions from $8,322 to $7,449. This maximum was already reduced from $9,708 in last year's budget. Additional reductions will only serve to further reduce the ability of financially needy students to attend a California non-public institution. Some of these students will join the others who decide to leave California to pursue their higher education elsewhere. Neither the existing award nor the proposed award amount are tied to the cost of attending a private college or university or to the cost to the State of educating such students at a California public four-year institution instead.

The Commission is recommending that the Legislature adopt a new statutory formula that would tie the maximum grant for Cal Grant recipients attending independent institutions to the estimated General Fund cost of educating a student at the public four-year institutions. This formula would provide Cal Grant students with an award that would cover approximately 38 percent of the average cost of a private postsecondary education.

Funding Source: Codifying a cost-neutral formula that will support the basic tenet of choice for all students is critical to the State's growing economy. The Commission is, however, very concerned about the Legislative Analyst's suggestion to fund the difference in the maximum award from the Student Loan Operating Fund (SLOF) reserves. The existing Student Loan Operating Fund reserve is approximately $151 million but future potential reductions in fund revenue sources, changes in the projected loan volume or default claim levels, and the necessity of SLOF transfers to meet the required minimum reserve levels in the Federal Fund dictate a cautious approach to using SLOF reserves for non-loan purposes.

The Cal Grant Competitive Program

As you may have heard, while the Cal Grant Entitlement awards serve qualifying high school graduates very well, the Cal Grant Competitive program does not serve its intended population nearly as well. Each year, the Commission is authorized to award 22,500 Cal Grant A and B awards to new and continuing students who do not qualify for an entitlement award. Many more students meet the academic and income qualifications for an award but are turned award through a competitive process that awards only the most needy and highest achieving students.

For the 2004-05 academic year, more than 140,000 students successfully met the financial and basic eligibility criteria for a Competitive Cal Grant award but only about one out of six of these qualified applicants received a Cal Grant:

- **117,216** qualified students remained unserved including **81,926** who planned to attend or were already enrolled in a California Community College, and only **19,244** who were not yet enrolled at any California college or university.

- The Commission believes that better information is needed to know how many of the affected students do not receive institutional aid and currently is researching this issue.

Most California Undergraduates Work to Help Pay for College

In addition to the vital Cal Grant programs, the federal Pell Grant program, and institutional grant aid, most financially needy California undergraduates work at least part time to help pay for college. In fact, according to the Commission's 2003-04 Student Expense and Resource Survey:

- Nearly half of the full-time undergraduates at the University of California, three-fourths of those at other four-year institutions, and nearly nine out of ten in the California Community Colleges reported working during the academic year;

- 87 to 98 percent of all part-time students also reporting working while attending college;

- Full-time students reported working 15 to 18 hours per week at on-campus or outside jobs during school at University of California and independent colleges and 20 to 26 hours per week on average at California State University and Community College campuses;

- Older, part-time students reported working 33 or more hours per week in all segments except University of California where the average was 24 hours a week; yet

- Research has confirmed that working more than 16 hours per week forces most students to reduce the number of units they take, adversely affects their academic performance, and increases the time it takes to complete their degree. Despite these negative effects, many California students do so anyway because they have few alternatives.

Most Students at Four-Year Institutions Also Must Borrow to Meet College Costs

Student borrowing has become the largest single source of financial support for undergraduates whose personal and family resources are insufficient to cover the cost of their education. Total student borrowing from the federal loan program alone **exceeds $55 billion**. Moreover, between 1993 and 2000, the percentage of baccalaureate recipients nationally who borrowed to help pay for college increased from 49 to 66 percent and their average student indebtedness upon graduation rose from **$12,100 to $16,888.**

In California, total student loan borrowing increased from $4.4 to $4.9 billion between Federal Fiscal Year (FFY) 2003 and FFY 2004. Growth in Federal Family Education Loan Program (FFELP) borrowing by California undergraduate and graduate students increased from $3.2 billion to $3.6 billion. Other California borrowing trends include:

- Nearly 50 percent of all full-time undergraduates at the CSU, 59 percent at the UC, and 72 percent of those at independent institutions reported borrowing in 2003-04;

- Seniors at the CSU reported an average cumulative loan debt of $14,400, whereas UC seniors and those at independent institutions reported average cumulative indebtedness of $17,900 and $28,100, respectively; and

- Available data indicate that older, independent undergraduates in these segments are even more likely to borrow to help pay for college and to incur substantially greater debt by the time they graduate.

Why is a Financially Healthy, Effective EDFUND Important to California?

There are currently 36 federal student loan guarantee agencies in the nation. Why does California need one and what benefits has the Commission's student loan auxiliary EDFUND provided to the State since its creation in 1997?

- The Commission and EDFUND pioneered fee waivers in the federal student loan program that reduced students' cost of borrowing for college;

- Through its guarantee services EDFUND generates Student Loan Operating Fund (SLOF) reserves. In the absence of the Commission as a guarantee agency, that revenue would have gone to competitors – some of them for-profit companies – outside California;

- EDFUND provides financial aid offices with superior consulting and technical support from an agency that puts student and school needs first; and

- EDFUND provides incentives for college campuses to lower student loan defaults through its innovative EDSHARE grant program.

The Commission and EDFUND Guarantee a Better Deal for All Students and the State

- Waiving the student loan guarantee fee has saved students over $212 million in the last 7 years and we are committed to waiving the fee again next year;

- Since FY 2002-03, the Commission's entire administrative budget has been funded by revenue generated by EDFUND, a direct savings to the state General Fund. This year, revenue generated through EDFUND provided:

  - $12 million for the Commission's administrative budget;
  - $10 million for Cal Grant public awareness and campus-based outreach programs;
  - $8.5 million for California Student Opportunity and Access Program (Cal-SOAP); and
  - $3 million in consulting and technical support for California college financial aid offices.
  - $5 million each year is dedicated to public service initiatives and programs; and
  - In FY 2004-05, the SLOF provided an unprecedented, one-time contribution of $146.5 million from its reserves to fund Cal Grants which helped to prevent a 20 percent reduction to these vital programs during the state budget crisis.

EDFUND Provides Exceptional Performance

Since the Legislature established EDFUND in 1997:

- The Federal Family Education Loan (FFEL) Program nationwide grew by an average annual rate of 10 percent; EDFUND's growth rate was over 20 percent. Why? Because more colleges chose EDFUND's student-centered, customer service-oriented approach to student loan guarantee services;

- EDFUND cut its student loan default rate in half, from 14.4 percent to 6.9 percent;

- EDFUND increased defaulted loan collection recoveries from $194 million annually to $385 million annually;

- EDFUND more than doubled annual revenues from $73 million to $151 million, while its standard loan program expenses grew from $49 million to $81 million annually; and

- EDFUND developed and sustained a superior audit record, with the recent resolution of all old (pre-1995) audit issues with the U.S. Department of Education.

Future Growth and Benefits Depend on Both the Immediate- and Long-Term Financial Health of the Student Loan Operating Fund

Because of past and potential future changes in federal policies, guarantee agencies must aggressively streamline processes, enhance business efficiencies, and expand their revenue base or risk becoming financially unstable.

EDFUND has dramatically increased its guaranteed loan volume and guarantee services since its inception and last year guaranteed $2.7 billion in new loans for California students (75 percent of all FFEL loan dollars in the state) and $3.0 billion to other students throughout the country.

EDFUND has achieved steady, robust revenue growth since its inception. However, the one-time use of $146.5 million in Student Loan Operating Fund Reserves to fund Cal Grant awards in 2004-05 and other non-loan program uses have substantially reduced the once strong and healthy SLOF reserves from nearly $300 million in FFY 2002-03 to $151 million in FFY 2003-04.

EDFUND remains solely dependent on FFEL Program revenues to support its operations. As the following table shows, this dependency puts the SLOF reserves at risk, because these revenues could be reduced significantly by proposed changes in federal policy (President's Proposed 2006 Budget, Reauthorization, and/or Budget Reconciliation), and through potential inroads made by its competition.

EDFUND since its inception and the Commission since 2002-03 are dependent on FFEL Program revenues to administer their programs and to provide essential customer service, training and on-going benefits to California students, families and institutions and to borrowers and institutions throughout the country. Insuring their continued effectiveness and capacity to provide high quality service is inextricably tied to General Fund support for Cal Grant awards and the financial strength and integrity of the Student Loan Operating Fund.

I am available to answer any questions that the members may have regarding the Commission's programs.

FFEL PROGRAM SOURCES OF REVENUE

Revenue Source	Rate and Basis	2004-05 Forecasted Amount*	Threats	Prognosis
Loan Processing And Issuance Fee (LPIF)	0.4% of Net Guarantees	$22.4 million	• Competitive Threats to New Loan Volume • Potential Federal Cuts in Rate	• Continued Strong Growth Possible if “0 G-Fee” Continued • Rate cut possible
Account Maintenance Fee (AMF)	0.1% of Loans Outstanding	$26.0 million	Federal Government does not fully reimburse; approximately $10 million is paid from Federal Fund	Federal Government will most likely keep the$16 million cap with the difference paid from the Federal Fund.
Default Aversion Fee (DAF)	1% on first-time 60-day Delinquent Accounts Brought Current	$9.8 million	Paid from Federal Fund.	Source of revenue will most likely remain the Federal Fund.
Net Recoveries on Loan Defaults	23% of collections on defaulted loans (up to 18.5% on certain other loan collections)	$59.7 million	Proposal in President’s Budget to reduce collection retention rate to 16 percent	Some reduction in collection retention rate almost certain. How drastic it will be is unclear.
Interest Income	Market rate interest on actual SLOF balances	$2.3 million	Earnings depend on interest rates and on size of the actual SLOF fund balances given cash flow needs	Interest rates are slowly rising but SLOF fund balances are also dropping significantly because of transfers to cover General Fund obligations
Voluntary Flexible Agreement (VFA)	Negotiated Rates based on VFA performance and specific provisions of agreement	$30.00 million	Renegotiation of VFA is currently underway but outcome and terms of a new agreement still uncertain at this time.	Chances of concluding agreement are good but without knowing final terms, it is not yet possible to project likely future VFA revenue levels.

*Fee revenues based on March 2005 budget forecast for 2004-05 federal fiscal year. Approximately $10 million in AMF and $10 million in DAF revenue are ultimately returned to the Federal Fund from the SLOF in order to maintain the minimum reserve in the Federal Fund.