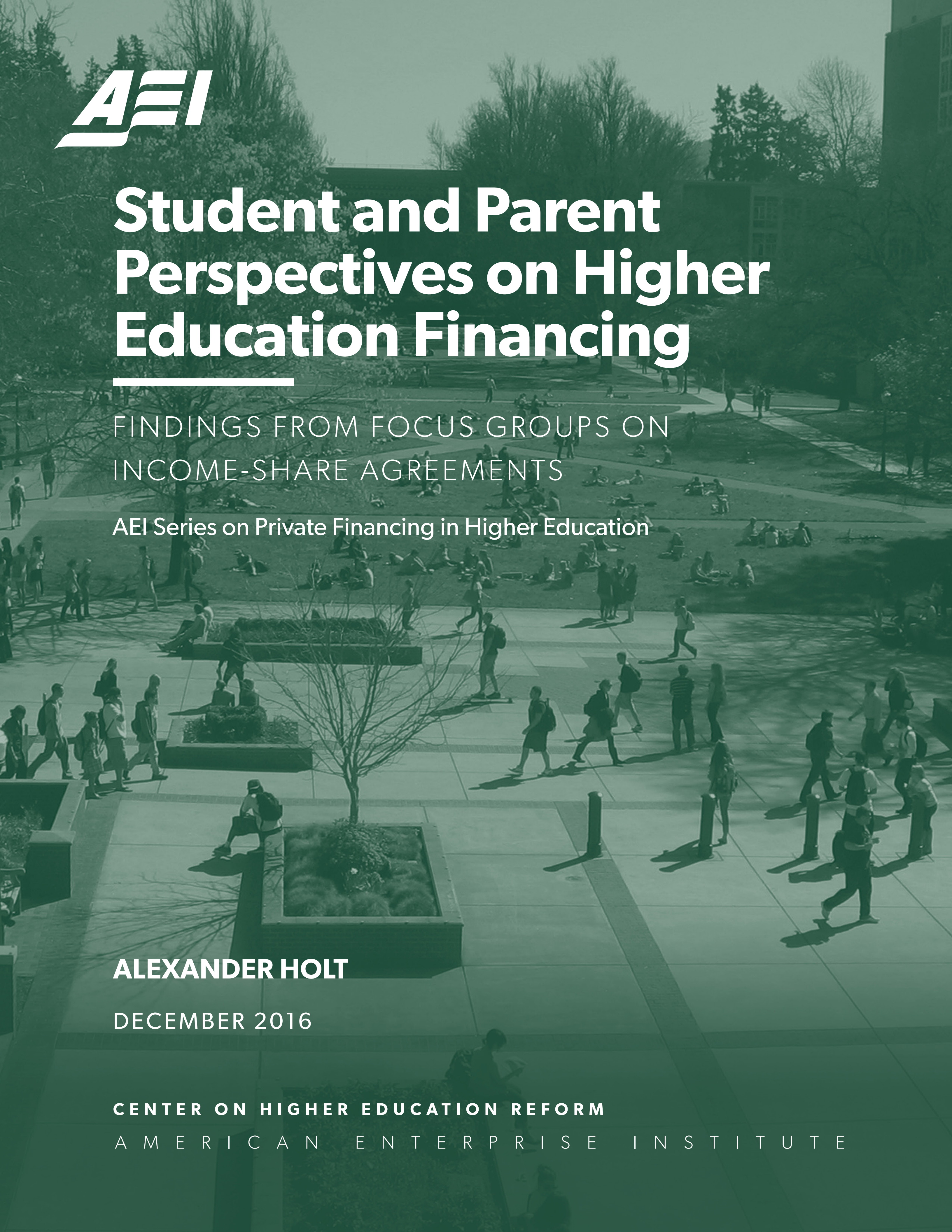

# Student and Parent Perspectives on Higher Education Financing

## FINDINGS FROM FOCUS GROUPS ON INCOME-SHARE AGREEMENTS

AEI Series on Private Financing in Higher Education

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**CENTER ON HIGHER EDUCATION REFORM**

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# Executive Summary

Policymakers have become interested in income-share agreements (ISAs) as an alternative to private student loans. With an ISA, students agree to pay a set percentage of their income for a set number of years in return for financing for their college educations. The main benefit of an ISA is that it acts as insurance for students who earn lower-than-expected incomes because payments are always a fixed share of income. However, few ISAs exist at present, and we do not know if students would actually prefer them as much as economic theory might suggest.

To study this question more in-depth, the American Enterprise Institute commissioned a series of focus groups to gauge attitudes of college-age students and parents of college-age students regarding ISAs. Many participants reacted positively toward ISAs and expressed an appreciation for the insurance-related component. Others disliked the idea of potentially paying back more than they would under a loan if they earned a high income. Participants were also concerned there was no way to pay an ISA back faster than the set term, as opposed to a student loan, which can be prepaid at no penalty.

# Student and Parent Perspectives on Higher Education Financing: Findings from Focus Groups on Income-Share Agreements

*This paper is the third in a series examining private financing in higher education from a number of perspectives.*

Contrary to common media narratives that question the value of a college degree, research shows that, on average, investing in higher education still pays off for students.[1] In fact, for those who complete their degree, the investment is perhaps more valuable than ever.[2] Some evidence suggests that low-income students benefit the most from completing a degree, in part because students from similar backgrounds with just a high school diploma have trouble finding well-paying jobs.[3]

But averages smooth over the fact that, for many, the investment does not pan out. Start with those who do not finish a credential: around 47 percent of those who enrolled in 2009 had not completed their program six years later.[4] Dropouts are much more likely to default on their loans, despite modest balances; loan-default rates are highest among those with balances of $10,000 or less.[5]

Earning a degree is not necessarily a guarantee of a good outcome either. A study from the Federal Reserve Bank of New York found that bachelor's degree recipients at the 25th percentile of earnings among B.A. holders earn about as much as the average high school graduate, which has been true for decades.[6] Many sub-baccalaureate credentials offer little or no positive return.[7]

Many Americans, in turn, do not repay their student loan on time. Nearly eight million federal loan borrowers are in default.[8] A recent study from the Brookings Institution found that 74 percent of students who attended a for-profit college and entered repayment in 2012 owed more on their student loans two years after they started to repay; the same was true of 64 percent of community college students. That same study found that after just five years, 28 percent of borrowers who started repaying in 2009 had defaulted.[9]

Because investing in higher education through student loans carries significant risk, borrowers need some protection if the investment does not pay off. Policymakers have focused on reducing these risks in the federal student loan program. Specifically, income-based repayment programs allow borrowers to pay a percentage of their discretionary income each month for a set period of years, at which point remaining debt is forgiven. That protection is designed to help borrowers avoid default during periods of low earnings, although many borrowers are not using it.

But maybe debt is not the best tool for financing a risky investment such as higher education.[10] In other areas of the economy, such ventures are often financed through equity investments in which investors share in the risk of failure in return for a stake in the potential upside that may result from a successful project. Unlike a loan, for which lenders are paid back no more than the principal plus interest, an equity investor earns a return proportional to the project's success. In theory, this should encourage greater access to college financing, providing greater incentive to maximize the chances of success.

In higher education circles, this thinking has led to a new type of financial product called an income-share agreement (ISA). An ISA shares a key feature with income-based repayment programs for federal student loans: payments are tied to income. Students who earn little will thus pay little or nothing back unless their income rises. Unlike federal loans, however, those who earn more will have to pay back more.

A handful of nonprofit and for-profit funds now offer ISAs.[11] Purdue University recently announced its Back a Boiler program, under which juniors and seniors enter into ISAs.[12] Policymakers and analysts have argued that a lack of legal and regulatory clarity has constrained the supply side of the ISA market.[13]

However, important questions remain about the demand side of this market as well. How do students and their parents view ISAs? What aspects of an ISA do they value? What aspects raise concerns? Would the average student prefer an ISA to a comparable private student loan?

Other researchers have raised similar questions. Researchers at the American Institutes for Research (AIR) asked students and families about ISAs by comparing them with federal loans and income-based repayment. They found that "when [students and parents] were presented with a more detailed comparison of a hypothetical ISA and a loan with an income-driven repayment plan . . . participants' views on ISAs were less favorable."[14] Additional research by AIR's Audrey Peek, Jessica Mason, and Matthew Soldner found that loan-averse students might prefer ISAs, although the research still compared ISAs with federal loans that have income-driven repayment plans.[15]

Comparing ISAs with federal student loans is a false choice. A more realistic comparison is with a private student loan. Federal loans are subsidized; they provide borrowers with much better terms than those available in the market. But they also feature annual borrowing limits as low as $5,500. Private lenders usually cannot compete with the more favorable terms on federal loans, which is why students are encouraged to first borrow the maximum in federal loans and then turn to private loans if they need additional financing. ISAs offered by private companies will not compete with federal loans for the same reasons, so ISAs are a substitute for private student loans in that students might use them if they face college expenses beyond what they can borrow in federal student loans.

To study the question from this perspective, AEI commissioned four focus groups to explore consumer preferences for ISAs compared with private student loans. This paper features impressions of students and parents of college students from focus groups conducted in February 2016. As is the case with focus group research, the participants are not a representative sample, and the findings are not generalizable to the wider population of students and parents. Rather, the focus groups provide a first look at how this particular group of people react to the new concept of ISAs. Their reactions, in turn, helped guide a more systematic, survey-based examination of attitudes toward ISAs. (The findings of such will be released in a separate paper.) They should serve as a springboard for other research on the topic as well. For a more detailed look at the methodology of our focus groups, see Appendix A.

## Key Considerations About ISAs

A few fundamental features make ISAs different from loans. ISA recipients agree to pay back a set percentage of income for a set number of years. They could therefore pay much less, or more, than the original amount received. With a private loan, borrowers pay back a fixed amount of principal and any accrued interest no matter their income amount, until the loan is paid off. Compared with a loan, an ISA provides a sort of insurance against the *downside risk* of not making those payments because of unemployment, underemployment, or some other cause of financial hardship. If borrowers do not earn enough, they do not make payments.

That insurance comes at a price, however. ISA recipients must also consider *upside risk*, or the potential that they will earn a high income and pay more on the ISA than if they had used a loan or other means of financing. Student loan borrowers would not worry about earning a lot of money; if anything, economic success would allow them to pay off their loans more quickly and save on interest payments. Not so with an ISA. If ISA recipients agree to pay for 10 years, then they will pay for 10 years. Because ISA payments are tied to income, ISA recipients who earn a high income will pay back more per month than they would with a similar loan and may pay far more in total over the course of the repayment period. To be sure, most ISAs will feature a maximum repayment cap, such that recipients will never pay more than, for example, five times the amount originally received.

Note that focus group participants did not explicitly use the terms upside risk or downside risk. Rather, I use these terms as shorthand for summarizing many of the thoughts voiced by the participants.

### Summary of Findings

In general, participants reacted positively toward ISAs. The most important theme to emerge from the groups was the tension between protecting against a bad outcome (downside risk) and the potential for an ISA to be much more expensive than a loan should the borrower earn a high income (upside risk). Many participants who were concerned about downside risk were enthusiastic about ISAs. Those who were skeptical of ISAs often cited upside risk.

Some participants argued that the inability to prepay made ISAs inflexible. They hope to be released from the financial obligation as quickly as possible and thus value their ability to prepay the loan and shorten their term. But while ISAs have an inflexible term, they have flexible payments. Because the ISA adjusts the payment based on income, some participants thought this would provide more flexibility than a loan and that they would have more freedom to take a low-paying, but formative, first job or internship. These differing views of freedom and flexibility explain why some participants responded more favorably to ISAs than others.

Another key theme to emerge was skepticism about ISAs. Participants wanted more information before entering an agreement. Although student participants desired more information, they quickly grasped the basic concept and asked probing questions indicating that, for the most part, they understood the trade-offs. Parents, however, had more difficulty understanding ISAs and more frequently attempted to graft loan concepts, such as interest rates, onto ISAs.

**Because the ISA adjusts the payment based on income, some participants thought this would provide more flexibility than a loan.**

Students and parents commented that parents typically make the financial decisions about paying for college. This is a mixed blessing for ISA providers. Parents in the focus groups were more focused on downside risk and generally more pessimistic about their children's job prospects, financial decision-making ability, and overall ability to navigate life. That makes ISAs more attractive to parents, but after a lifetime of experience with loans and debt, parents also have more trouble understanding and trusting a new financial concept such as an ISA.

### Concerns About Upside Risk

After learning about ISAs in a neutral fashion, some participants voiced concerns about upside risk. While noting the benefits of the insurance mechanism, many focused on the potential to pay more than if they had a loan. In the sessions, students began to consider how to game the product, saying they would take an ISA only if they believed they would pay less than they would under a normal private student loan. This suggests that they thought the downside risk (insurance mechanism) protection was not worth what they would give up in upside risk (potential to pay more than they would under a loan). The majority of parents said they thought an ISA was riskier than a loan.

*I don't know, it's definitely not fair to people who make more money. It just favors people who make less somehow.* —Student

*With traditional private loans, if you come into some really good amount of cash or you get a really good pay raise, you can just pay off a big chunk of your loan, and you can do what you want.* —Student

*I wouldn't [take out an ISA] because if I borrowed $30,000, I could pay $60,000 back at the end. If we want our kids to be successful—she could be paying these investors $60,000 on a $30,000 [ISA] at the end of 10 years if she is successful. Whereas on the other loan, I'm paying exactly . . . what I borrowed.* —Parent

*It sort of is like a safety net in [the] sense that you know it's going to be this percentage of your income even if you're making $20,000. . . . What I don't like about it is that I'm thinking with my loans, hopefully one day I make enough money . . . and pay my loans off that I have now and just am done with them forever. . . . In that sense, I don't like it because I feel like you're sort of stuck in this percentage.* —Student

Not all students minded the upside risk.

*The only negatives come in if I'm really successful and at that point . . . sure I'll be happy to pay more. . . . In the grand scheme of things, it won't really matter. [Moderator: You won't be that upset about paying back . . . more money?] I won't, like, be homeless.* —Student

*In a standard loan you also pay more than what you [were] loaned. I mean, it's interest, so, like, you're guaranteed to be paying more than what you were loaned. Whereas with this, there is a chance you end up paying less.* —Student

## Betting Against Yourself or a Win-Win?

Students also expressed a concern with the premise of an ISA—that the only way they will benefit from an ISA versus a loan is if they earn a low income. Therefore, participants felt they were betting against themselves.

*It feels like you are . . . betting against yourself. [There] could be a potential [that I don't get a job] in the next four years but I am hoping [that is not the case].* —Student

*Effectively with the income-share agreement, they're betting on you, and you're betting against yourself. —Student*

*It seems un-American to me. If you worked your behind off to get in a job that pays more money, this feels like it's penalizing you.* —Parent

But some participants felt like ISAs were a win-win. If they earned a high income, then they could repay it easily; if they did not, then the ISA protected them. Furthermore, they liked that the ISA provider made money only if the student went on to make money after school.

*It feels much more like an investment in myself, which kind of makes the relationship feel more comfortable, like it's two ways.* —Student

*I kind of like the concept of having someone really invest in your future and having not only your family behind you but this other entity as well. They put money into your education so they also want to see you do well.* —Student

## Participants Contemplate How People Could Game an ISA

Students suggested that people entering fields linked to volatile or low-paying careers should take an ISA and that those entering stable, high-earning professions should avoid them. This may partially be a result of the worksheets provided to the focus group participants: while students were informed that terms could adjust based on major, they were shown only one example. (See Appendix B for the worksheets provided to participants.) Still, many students and parents said they would take out the ISA only if they thought they would earn below the average and, if the term were short enough, that they could avoid the ISA provider capturing their higher income later in their careers.

> [*An ISA would be preferable*] *for a student who doesn't plan on going into the workforce right after graduation.* —Student

> *If you graduate with zoology, there aren't that many opportunities in zoology everywhere. If you are going to be waiting a while to get a job,* [*you should take the ISA*]. —Student

> *I might just take my time. I mean, if I don't need to pay it right away, why would I?* —Student

## Focus on the Repayment Cap

ISA providers know students are concerned about upside risk, so they use a repayment cap to mitigate that concern. A repayment cap can be thought of as "a Zuckerberg clause": if someone becomes the next Mark Zuckerberg and makes a billion dollars five years out of college, then they will not owe an ISA provider $50 million, for instance, but instead some lesser, capped amount.

Keep in mind, most people will not hit the repayment cap because ISA providers tend to set the cap relatively high—say, five times the amount borrowed. To reach such a cap, borrowers would need to earn incomes far above what is typical. Providers could in theory set the cap lower, but the point of an ISA is for the highest-earning borrowers to help offset the otherwise uneconomical returns from lower-earning borrowers. A repayment cap at twice the amount borrowed would mean that an ISA provider must charge all borrowers a much higher percentage of their incomes during repayment, which would likely dissuade students from using them.

Even though few borrowers would ever reach the payment cap, statistically speaking, it was a big concern for the focus group participants. In fact, some students had a tendency to see the cap as what they would pay, not as a limit to what they could pay.

> *The really big cap freaks me out.* —Student

> *Paying somebody $300,000 for a $30,000 loan is ridiculous. . . . Just put a gun to my head and kill me now. This doesn't make any sense at all.* —Parent

## Participants Appreciate the Insurance Component

Students and parents usually understood and appreciated the value of the insurance component of an ISA. They recognized how an ISA protects against downside risk and, in general, warmed to the concept of an ISA during the two-hour focus group. Many participants recognized that ISAs might be good in theory, but not for themselves in particular. Certain student participants were more enthusiastic about ISAs than others and seemed to place a higher value on protecting against downside risk.

> [*Paying a set percentage of my income rather than a nominal amount is*] *the biggest thing for me. . . . If I'm not making any money, this is a great safety net.* —Student

> *I'd rather* [*I end up having to pay more*] *than having to stress over "do I have enough at the end of the month to pay the bill coming up?"* —Student

> *A huge thing for me is . . . if something bad happens to you and you're just out of work for a year, you're fine. You just owe literally nothing versus if you're out of work for a year, you could get seriously [screwed] over by loans.* —Student

> *It eliminates a lot of stress because [with a private loan, it's] just accruing interest every year. With the income-share agreement, that whole stress doesn't exist.* —Student

> *I'm not getting any help from my parents. If I graduate and I don't have a job and I have loans to pay, that's on me. I already know that I'm not going to be making a lot of money out of school. So this is safer for me, the income-share agreement.* —Student

> *I like the idea of it being a set percentage of income since that's a big wild card and you don't necessarily know what their first job is going to be. So I think it might work to their advantage.* —Parent

Even while still skeptical of whether they would take an ISA, some wanted even more insurance protections in an ISA that would relieve payments in the event of unforeseen life circumstances, such as incurring high medical bills.

> *[I would like for an ISA to have] a safety net if something big [like a medical issue] happens. . . . [I would like] an option where you could give a lesser amount. A safety net on the expenses side because on the income side it would take care of itself.* —Student

> *How flexible [is an ISA]? Because at least with student loans if you have . . . a hardship you can probably call and maybe lower your payment. But this just seems like it traps you for 10 years.* —Student

## Differing Views on Freedom and Flexibility

A common argument from ISA proponents is that ISAs provide more freedom to recipients compared with loans because the payment is guaranteed to never be more burdensome than a fixed percentage of income. Many participants found ISAs appealing for this flexibility, which would allow them to pursue a lower-paying job or internship.

Participants' perspective of what life will be like after college explains how they view flexibility. For instance, some participants, when thinking about loans and before hearing about an ISA, were concerned about how and if they could pay off their loans after graduating. Not surprisingly, many of these students found an ISA enticing because it led to greater flexibility.

> *When you first graduate, some people don't have a job right away so it's hard to start paying it off right away. And luckily there's some grace period but like with private loans you don't [have one].* —Student

> *I love how flexible [the ISA] is.* —Student

> *There's no motivation to try and pay [the ISA] back sooner. It's a nice little stress-free thing. You can start saving money for your future. You can start investing. There's much more freedom with the income-share agreement.* —Student

> *I think kids do end up taking the highest-paying job because sadly we all value our self-worth to our paycheck, which is wrong. [The ISA] would give the kid less pressure to take the high-paying job.* —Parent

> *Say you're trying to start a company. [With an ISA] you can do that right away and not have to worry about making payments right away.* —Student

Others worried that ISAs would feel less flexible than a loan. Students in the focus groups wanted the option to pay off their loans early. For students, a 10-year repayment schedule, which is the standard for a federal student loan, already seemed too long. Students saw the ability to prepay their loans as an important benefit, a benefit that does not exist in an ISA. They valued the ability to "get it over with" and pay off the loans quickly.

> *I'm leaning toward the private loan. I like how you can pay—if you get a certain amount you can pay that off right now, pay a little more than I normally do.* —Student

> *I think it would be easier to have a set* [*nominal amount owed per month*]. —Student

> *I just like that if you are committed with a regular loan, if you are committed to it you can control how much interest that you are accruing and get it off the table.* —Student

> *I want my kids to know what they are going to pay. It needs to be structured, because that way they can depend on themselves to know what they have to make.* —Parent

## Shorter Repayment Terms Are Better

In the focus groups, participants were asked to consider three ISA options with a repayment lengths of 10, 15, or 20 years. The shorter-term options required that they pay a higher percentage of income than the longer-term options.

Nearly everyone preferred the shortest option, with some asking for even shorter terms. The participants understood that a longer term could mean that they would pay a significantly lower percentage of their incomes over that time, but students did not want an obligation lasting longer than 10 years. Parents also worried that their children would need their entire income later as they entered other stages of life and buy a house, get married, or have a child.

> *It is all about time to me. . . . In fact, I would be more interested if they had a five-year plan with an even higher percentage."* —Student

> *In 10 years or so I'm 30 or 35 years old and I've got a family and stuff and there's a lot of stuff I'm going to be paying for then. I would rather have it be done.* —Student

> *I would much rather have this paid off in a short amount of time because then you can enjoy the money when you're actually making more money. . . . I don't want to commit to something that long.* —Student

> *I hate owing people. I want it done and out of the way.* —Parent

> *Hands down, 10 years. The emotional weight of having that debt follow you for 20 years is too much.* —Parent

## Participants Value the Option to Repay an Obligation Faster

Participants wanted a way to repay an obligation faster and end their term earlier like they can with a loan. That desire is at odds with how an ISA works, although an ISA's repayment cap does allow an ISA recipient to fulfill the obligation before reaching the requisite number of years of repayment. A cap is not analogous to paying down a loan early though. In any case, the ability to repay faster and to somehow buy out of the plan was a requested feature.

> *At least with traditional private loans if you come into some really good amount of cash or you get a really good pay raise, you can just pay off a big chunk of your loan, and you can do what you want. Even with the cap, I like the idea that you make the decision more with the private loan.* —Student

> *You are locked in* [*with an ISA*]. —Student

> *But is there a pay-off-early option [for the ISA]?* —Parent

### General Skepticism About ISAs

Some participants felt uncertain why ISA providers wanted to invest in students; some seemed to be wary of a profit motive. However, a few students appreciated the idea of the ISA provider having the financial position of wanting the student to succeed—that meant they were both on the same side and had aligned motives.

> *Are they gambling on you making more than you owe long term? I just don't understand. If I don't have a job for 10 years, and it's like, "Thanks for school, see ya." After 10 years, how does that work?* —Student

> *Why are you investing in me, a random college girl [who] doesn't really know what she wants to do? Why?* —Student

> *Is this safe?* —Student

> *Is it a scam?* —Student

> *Something doesn't seem right about it.* —Student

> *Does anybody remember their American history with indentured servants? That's what it sounds like to me. [Another participant: Yeah, like sharecropping, right?] That's exactly what it sounds like.* —Parent

> *It looks like you've got people who are speculating on college kids, basically. They speculate on gold or silver or whatever, and now they're saying, "Let's speculate on college kids."* —Parent

> *I can't get past the concept that somehow or another the student is a commodity to be exploited.* —Parent

### Participants Care About the Profit Motive of an ISA Provider

Students were asked how they would feel if they knew the ISA came from a nonprofit whose expressed goal was to subsidize students going to college. Most students reacted positively.

> *I would [rather] give money to students than to a bank. . . . I would rather help someone right out of school.* —Student

> *Either way you're throwing money at somebody. I would rather throw it at someone and help them go to school than throw it at a banker or the government.* —Student

> *I already have a job lined up. I personally—financially it wouldn't be the best thing for me to choose [an ISA], but I would probably still consider it if it was a nonprofit. I would consider just by the virtue that it's helping to give back to other students.* —Student

### Students Would Look to Parents and Schools for Advice About ISAs

Nearly all students agreed that they would ask their parents or a parental figure about using an ISA. In general, these students said that they look to their parents for advice on financing their own education. Parents agreed, saying they would sit down with their child to look at ISAs carefully and run the numbers. They indicated they had been primarily in charge of determining their child's financing. In one of the sessions, the moderator asked which parents thought they had done more research than their children on financing higher education. Everyone's hand went up.

> *My experience with my kids is I think they listen to what we tell them. They come to us for advice. I think if you sell this idea to us, you've got a good chance of selling it to our kids.* —Parent

> *I would probably go to, of course, my parents, or something like that.* —Student

> *I think informing the parents is probably the best way to implement this new concept just because I think they are the ones making most of the decisions.* —Student

> [*Moderator: When you saw that first bill came in with that number? What was your thought process of . . .* ] *Called my mom.* —Student

Students also said they would look to their school's financial aid office and be more trusting of an ISA product if it came through the school.

## Parents and Students Have Different Expectations of Themselves and Each Other

Students tended to be more positive about their job prospects, futures, and abilities to face life's demands. They quickly grasped the concept of ISAs and asked probing questions that indicated an understanding of the potential trade-offs of the product. On the other hand, parents had less faith that their children could accomplish anything on their own.

> *My son has no concept of money; he just doesn't. He would definitely rely on me to help him figure it out.* —Parent

Ironically, parents had more trouble understanding ISAs, even though they assumed they understood the concept better than their children would. They had difficulty internalizing the idea that the ISA did not come with an interest rate, that interest would not accrue, and that there was not a set amount to pay back. They seemed more at ease thinking about debt and loans and a bit frustrated by this new concept.

> [*I would prefer an ISA that was*] *interest free.* —Parent

> *It says no interest rate, so then what is it based on?* —Parent

> *I guess my question is, there's no interest rate on the income share. Okay. Where is the money coming from?* —Parent

Parents doubted whether their children could navigate responsibilities once on their own. They worried that their children could not budget for expenses, would not find a job, and would have to move back home after college. Some parents had children who had done just that.

> [*My daughter is in medical school and will graduate with $300,000 in debt.*] *I really tried to talk her out of being a doctor because I was worried about the debt.* —Parent

> [*My children would take the ISA with the longest term*] *because they don't have long-term thinking.* [*Another participant: Yeah, I agree.*] —Parent

> *It is like talking to a wall. I think part of it is this generation. It is like it is a little different the way they have grown up. They are unstoppable and think they can conquer the world and don't know the consequences of how things are.* —Parent

## Concluding Thoughts

In general, participants were positive about ISAs. Even though this was their first exposure to the concept, most understood it quickly and were interested in learning more. The most attractive parts of an ISA were its ability to mitigate downside risk and provide more flexibility to borrowers. These students and parents worried about years of low income or unemployment and appreciated how an ISA frees cash from going toward a loan payment so that it can be used for other living expenses. They recognized that, with an ISA, a student has a greater ability to take a low-paying job, take time off from work, or take an unpaid internship. Many even accepted the trade-off of more flexibility for potentially paying more if they earn a high income. Participants also may have been more open to ISAs if it were offered by their school or a nonprofit instead of a bank or other for-profit entity.

Upside risk and flexibility were also the most commonly cited reasons that other participants did not like ISAs. These participants disliked the idea of paying more if they earned more and thought it risky that they could pay far more with an ISA than they would with a loan. They also thought ISAs were inflexible because there was no way to pay it off sooner. Many students were hoping to pay off their loans in fewer than 10 years. They saw the debt as a burden from which to escape as quickly as possible. Thus, different views of risk led to different impressions of ISAs from participants.

## About the Author

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### Previous Papers in This Series

- **New Funding, Aligned Incentives: How Private Financing Options Can Foster Higher Education Innovation**, *Kevin J. James*
- **Students' Futures as Investments: The Promise and Challenges of Income-Share Agreements**, *Jon Marcus*

# Appendix A: About the Focus Groups

To explore consumer impressions of ISAs, AEI commissioned Echelon Insights, an opinion research and analytics firm in Washington, DC, to conduct four focus groups featuring college students and parents of college students. The research was conducted in February 2016 in Columbus, Ohio, and Boston, Massachusetts.

In each location, Echelon convened two distinct groups: 10 current college students who either have loans or expect they will need loans, and a second group of 10 parents whose children were either high school seniors or college-age students. Participants were drawn from different income, racial, and ethnic groups. The students attend both public and private colleges, although the students in Ohio mostly attended a large state university. The parents and students were recruited separately and not related.

AEI worked closely with Echelon Insights to develop a moderator's guide and series of three worksheets, which allowed focus group participants to compare ISAs with loans under different scenarios. Echelon Insights independently ran the focus groups and had full editorial independence in producing their report on the focus groups. In the focus groups, the moderator asked participants about their worries regarding paying for school and then introduced the concept of an ISA in basic terms and solicited students' responses to the idea. (What did they like about an ISA? What caused concern?) Participants were then shown the worksheets featuring a comparison of an ISA with a private student loan and a comparison between different types of ISAs.

# Appendix B: Worksheets Provided to Focus Group Participants

**Worksheet A**

| Feature | Private Student Loan | Income Share Agreement |
|---|---|---|
| Payments | Fixed monthly amount over payment term<br>*(eg., $170/mo. for 10 years per $10K borrowed)* | Fixed percentage of income over payment term<br>*(eg., 4% of income for 10 years per $10K borrowed)* |
| Total amount paid | Amount of the loan plus interest | Varies based on income earned over payment term—no fixed amount that must be repaid |
| Maximum amount paid | Only have to pay the loan amount plus interest, though there is no limit on how much interest can accrue | Some contracts will cap how much you have to pay if you earn a high income, meaning a borrower would never repay more than a maximum amount. |
| Interest rate | Average rates are between 9 and 12 percent | None |
| First payment | After graduation<br>(though interest accrues while in school) | After graduation |
| What if I'm unemployed? | Forbearance available in some cases, though the loan balance will grow because of interest | Payments are zero when you have no income |
| Length | Usually ten or fifteen years, but can be paid off early | Usually ten or fifteen years, can only be paid off early if the cap is reached |

## Worksheet B

Becky is enrolling in college, and after applying for federal grants and loans, still needs an additional $3,750 per year to help pay for her education. If she needs the same amount each year, by graduation she will have borrowed a total of $15,000 in non-federal loans.

She is considering taking out a private student loan to cover these costs. The interest rate is 10%, and she would pay it back after she graduates in fixed payments of $253/month for ten years. In total, with interest, she will wind up paying back $30,359.

Becky is also considering an income share agreement. In this case, she agrees to pay 5.5% of her annual taxable income for the ten years immediately after graduation. The amount she will wind up paying back depends on how high Becky's salary is when she graduates and how quickly it increases.

If Becky is very successful, earning an average annual salary of $96,049 over the course of ten years, she will have an average payment of $375/month. However, if Becky doesn't find a job during her first year out of college, she will begin making payments only when she is employed and has taxable income. If after that first year of unemployment, Becky makes an average salary of $33,018 for the remaining nine years, she would have an average payment of $151/month. If Becky finds a job right after college and earns an average salary of $57,629 over the course of ten years, she will have an average payment of $264/month.

Of these two, the options boil down to:

**Traditional Private Loan.** Borrowers can know how much they will be expected to pay back, **a fixed amount each month after they graduate**, regardless of how much money they make. **They will wind up re-paying a fixed amount of money**—principal and interest for the term of the loan—regardless of what their career looks like after graduation.

**Income Share Agreement.** Borrowers will pay a variable amount back each month—a set percentage of their income—making it an **amount that will change based on how much money they are earning**. In years where they make less money, they will pay less. In years where they make more money, they will pay more. **They will wind up re-paying an amount that is based on how much they earn** over the term of the agreement.

## Worksheet C

John is also enrolling in college, and he too needs an additional $3,750 per year above his federal aid to pay for his education. Upon graduating, he will have borrowed a total of $15,000 over four years. John has already decided he would like to enter into an income share agreement rather than a loan, but is having difficulty deciding between three options.

The first option is the exact same as Becky's—he would pay 5.5% of his income over ten years. He will have an average payment of $264/month if he makes a starting salary on par with his peers ($48,000).

The second option offers a lower percentage that he would have to pay—3.5% of his annual income. However, he would make payments over the course of 20 years. He will make an average payment of $208/month over the course of 20 years if he earns the typical starting salary for college graduates.

The third option offers a slightly higher percentage—4% of his income. Payments would be over the course of 15 years, not 20. He will make an average payment of $213/month over the course of 15 years if he earns the typical starting salary for college graduates.

Of these three, the options boil down to:

Option 1: A plan with a **higher percentage of income** to be paid back each year, done over a **smaller number of years**, with a fairly **low cap on the maximum amount to be repaid**.

Option 2: A plan with a **lower percentage of income** to be paid back, done over a **larger number of years**, with a **medium cap on the maximum amount to be repaid**.

Option 3: A plan with a **lower percentage of income** to be paid back, over a **medium number of years**, but a much **higher cap on the maximum that would be repaid**.

# Notes


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