

**Prepared For:**

The Coalition for Educational Success: Preparing  
the New American Workforce

# An Analysis of Taxpayer Funding Provided for Post-Secondary Education: For-profit and Not-for-profit Institutions

**Prepared By:**

Professor Bradford Cornell  
*Visiting Professor of Financial Economics, California Institute of Technology*

Simon M. Cheng, CFA  
*Vice President*

Charles River Associates  
1055 East Colorado Boulevard  
Suite 420  
Pasadena, CA 91106-2327

Date: September 8, 2010

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## Disclaimer

*This report was prepared at the request of The Coalition for Educational Success: Preparing the New American Workforce. It is based on data and information that were available at the time of the analyses. If additional data or information becomes available we may update or modify our report.*

The primary focus of this paper is to determine and compare the total costs borne by taxpayers for public and for-profit postsecondary colleges that are eligible to receive funding under Title IV of the Higher Education Act and other sources of government funding. For purposes of this paper, government funding includes *all* financial funding provided by the federal, state and local governments.

## **Executive Summary**

In evaluating its proposed “Gainful Employment” rule as well as future government investments in higher education, the U.S. Department of Education (“DOE”) should take into account the significant taxpayer savings provided by career and for-profit colleges. In the most conservative analysis, where only direct costs to taxpayers are considered, for-profit 2-year institutions produce graduates at a cost to taxpayers that is \$25,546 lower on a per student basis than the public 2-year institutions. This amount takes into account the costs to taxpayers for providing federal direct loans to the students at the for-profit and public 2-year institutions. When indirect costs such as taxes paid by for-profit schools and lost revenues from tax-exempt public institutions are taken into account, the differential between for-profit and non-profit institutions is even greater.

Default rates on student loans have a small impact on the taxpayer cost differential between the two types of institutions. According to default data provided by the DOE, the cumulative lifetime default rates for the for-profit 2-year institutions and public 2-year institutions are 26.0% and 21.4%, respectively, for the federal loans that were originated in 2003 that entered repayment through September 30, 2009. Again, in the analysis presented above (which includes a conservative assumption that the recovery rate is 0% on defaulted loans), the total taxpayer cost for providing federal direct loans per graduated student for two-year programs is \$709 for public 2-year institutions and \$4,115 for the for-profit 2-year institutions. If one were to assume a recovery rate of 60%, the total costs to taxpayers for providing federal direct loans per graduated student would decrease to \$284 for public 2-year institutions and \$1,646 for the for-profit 2-year institutions.

In summary, the total taxpayer cost per graduated student is significantly higher at public 2-year institutions than at for-profit 2-year institutions. The table below highlights that the total

taxpayer cost per graduated student is more than \$25,000 higher at public institutions than at for-profit institutions:

	Public 2-Year Institutions	For-profit 2-Year Institutions	Difference
	[A]	[B]	[B] minus [A]
(Per Graduated Student)			
<b>Direct Government Funding Provided by Taxpayers</b>	\$32,163	\$3,211	(\$28,953)
<b>Total Taxpayer Cost For Providing Federal Direct Loans</b>	\$709	\$4,115	\$3,406
<b>Total Taxpayer Cost Per Graduated Student</b>	\$32,873	\$7,326	(\$25,546)

For-profit 2-year institutions also deliver clear value to taxpayers in student outcomes. More than 75 percent of 2-year for-profit college graduates were placed into jobs within six months. We are unable to compute the placement rate for public 2-year institutions because the data is not available.

Student demand for higher education continues to grow as employers require higher skills while depending more heavily on schools for “on-the job” training. But the capacity of traditional not-for-profit schools has not kept pace, with the number of public 2-year institutions shrinking by 4.0 percent between 1996-97 and 2006-07. During this time, the number of the for-profit 2-year institutions increased by 13.4 percent, reflecting their focus on innovation and convenience to meet the needs of non-traditional students.

Importantly, both not-for-profit and for-profit college growth is crucial to meet future student demand. Continued government support to finance higher education is critical to assure student access to higher education. For example, in 2007-08, about half of all full-time undergraduate students relied on government loans to finance their higher education.<sup>1</sup> In stewarding these scarce public funds and in setting policy, government should clearly understand the dramatic costs savings and value provided by career colleges.

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<sup>1</sup> Based on full-time, full-year undergraduates at all institutions. Source: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Table 343

## **Postsecondary Educational Institutions**

Postsecondary educational institutions are schools, colleges and universities that are designed to meet the continuing education needs and interests of adults. These institutions provide academic, career and technical, and continuing professional education programs after high school. Degree-granting institutions include almost all 2- and 4-year colleges and universities that grant an associate or higher degrees (e.g., Bachelor and Masters degrees) and whose students are eligible to participate in the Title IV federal financial aid programs. Title IV programs, which are administered by the DOE, provide financial aid to postsecondary students. For purposes of this paper, degree-granting institutions exclude institutions offering only career and technical programs, which are shorter than 2 years.

There are three groups of postsecondary degree-granting institutions: (1) public institutions, (2) private not-for-profit institutions, and (3) private for-profit institutions. Public institutions are controlled and operated by publicly elected or appointed officials and derive their support primarily from public funds. In 2007, there were 1,685 public institutions in the United States with approximately 13.5 million full-time and part-time students, as shown in Exhibit 1. For example, the University of California, Los Angeles is a 4-year public institution and Pasadena Community College is a 2-year public community college. A 2-year public institution offers only associate degrees whereas a 4-year public institution grants mostly bachelor and higher degrees.

**Exhibit 1: Postsecondary Degree-granting Institutions in the United States**

	Public Institutions			Private Not-for-profit Institutions			Private For-profit Institutions			All Institutions
	4-year	2-year	Total	4-year	2-year	Total	4-year	2-year	Total	
<b>Number of Degree-granting Institutions, 2007-08</b> (as % of all institutions)	653	1,032	1,685 39%	1,532	92	1,624 37%	490	553	1,043 24%	4,352 100%
<b>Enrollment, fall 2007</b> (as % of all institutions)	7,166,661	6,324,119	13,490,780 74%	3,537,664	33,486	3,571,150 20%	925,873	260,325	1,186,198 7%	18,248,128 100%
<b>Associate's degrees, 2007-08</b> (as % of all institutions)	71,514	507,006	578,520 77%	38,251	6,537	44,788 6%	68,450	58,406	126,856 17%	750,164 100%
<b>Bachelor's, Master's, First-professional and Doctor's degrees, 2007-08</b> (as % of all institutions)	1,371,951	N/A	1,371,951 59%	837,193	N/A	837,193 36%	133,969	N/A	133,969 6%	2,343,113 100%

Sources: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Tables 5 and 187

A private not-for-profit institution is an educational institution in which the individual(s) or agency in control receives no compensation other than wages, rent, or other expenses for the assumption of risk in operating the institutions. It generates revenues primarily from sources other than public funds and is controlled by an individual or agency other than a state or the federal government. Private not-for-profit institutions may have been established by religious organizations or independent private entities. There were approximately 3.6 million students enrolled in 1,624 private not-for-profit institutions in the United States in 2007. (See Exhibit 1) Nearly 95% of these institutions are 4-year colleges and universities, such as Stanford University and Claremont McKenna College, which offer programs leading to bachelor and higher degrees.

Private for-profit institutions, also known as proprietary institutions, are education business organizations that prepare graduates for jobs and career advancement. These institutions receive little public funding and generally offer a focused range of programs in high-demand occupational or professional fields. Close to 1.2 million students were enrolled in private for-profit institutions in the United States in 2007. (See Exhibit 1) ITT Technical Institute, University of Phoenix and Strayer are some of the private for-profit institutions. Unlike the public and private not-for-profit institutions, about half of the degrees granted by private for-profit institutions are associate degrees.

Private for-profit institutions typically attract many non-traditional students. The “traditional” postsecondary students are characterized as those who have earned high school diploma, enroll full-time immediately after finishing high school, depend primarily on parents for financial support, and either do not work during the school year or work part-time. Traditional postsecondary students are generally able to spend most of their time on their studies and extracurricular activities at school. In contrast, non-traditional students have family and work responsibilities competing with school for their time, energy and financial resources. While there is no precise definition of “non-traditional” students, they are commonly defined in research a student who has one or more of the following characteristics: delays enrollment (does not enter postsecondary education in the same calendar year that he or she finished high school); attends part time for at least part of the academic year; works full time (35 hours or more per week); is considered financially independent; has dependents other than a spouse (usually children, but sometimes others); is a single parent (either not married or married but separated and has dependents); or does not have a high school diploma.<sup>2</sup>

According to a 2002 study conducted by National Center for Education Statistics (“NCES”) at the DOE, only 11.3% of total students at private for-profit institutions in the United States were characterized as traditional students in 1999-2000, as shown in Exhibit 2. This is similar to the percentage of traditional students at public 2-year institutions. In contrast, the percentage of traditional students at public 4-year and private not-for-profit 4-year institutions ranged from 42.5% to 50.0%. (See Exhibit 2) Private for-profit and public 2-year institutions had high percentages of students who were financially independent, delayed enrollment, had dependents or worked full time, as shown in Exhibit 3.

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<sup>2</sup> U.S. Department of Education, National Center For Education Statistics (NCES), *Nontraditional Undergraduate*, NCES-2002-012, August 2002, pp. 2-3.

**Exhibit 2: Traditional versus Nontraditional Students at Public and Private For-profit Institutions**

Type of Institution	Traditional	Minimally Nontraditional	Moderately Nontraditional	Highly Nontraditional
Public 2-year	11%	14%	35%	40%
Public 4-year	43%	20%	23%	14%
Private Not-for-profit 4-year	50%	15%	16%	19%
Private For-profit	11%	15%	39%	35%

Source: U.S. Department of Education, National Center For Education Statistics, *Nontraditional Undergraduates*, August 2002, Table 1.

**Exhibit 3: Percentage of Total Students With Non-Traditional Characteristics**

Type of Institution	Financially Independent	Attended Part Time	Delayed Enrollment	Worked Full Time	Had Dependents	Single Parent	No High School Diploma
Public 2-year	64%	70%	59%	54%	35%	16%	10%
Public 4-year	38%	33%	32%	26%	18%	9%	2%
Private Not-for-profit 4-year	37%	28%	34%	29%	19%	9%	3%
Private For-profit	73%	22%	68%	41%	44%	27%	16%

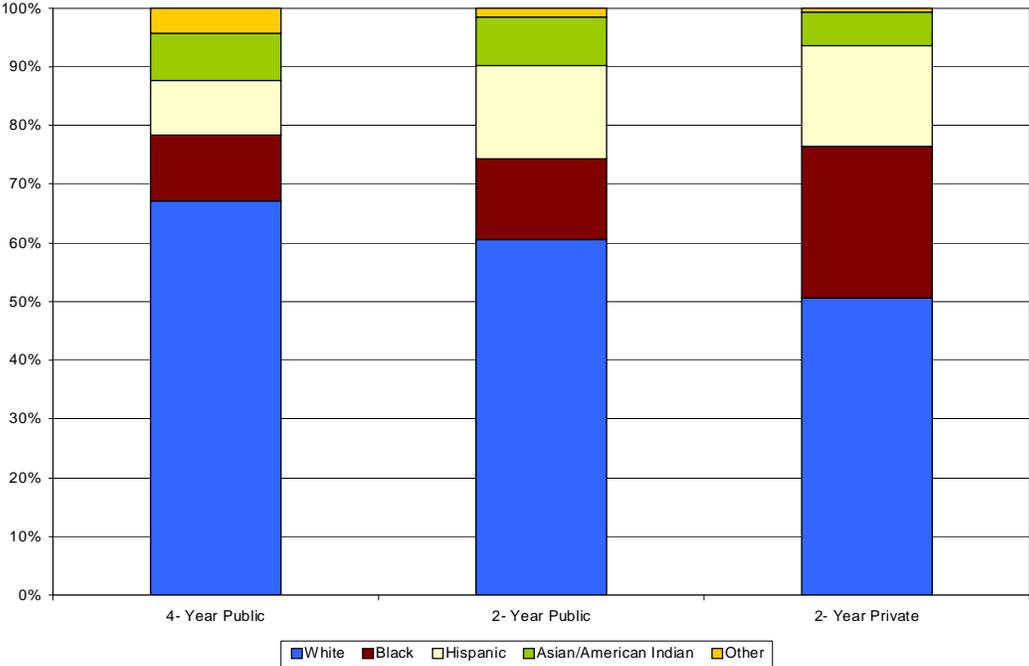
Source: U.S. Department of Education, National Center For Education Statistics, *Nontraditional Undergraduates*, August 2002, Table 2.

Private for-profit institutions in the United States also serve a disproportionate number of minority students, as many of these students are the first in their families to attend college. In 2007, about 48.8% of the students at the private for-profit 2-year institutions were Black, Hispanic, Asian and other minority races, as shown in Exhibit 4. The public 4-year and 2-year institutions had only 28.5% and 38.0%, respectively, in minority students as of 2007.

Many students at the career and community colleges received financial aid, such as Pell Grants and federal loans, from the federal government. The default experience of federal student loans is related to the mix and socio-economic demographics of these students, and may not depend

upon whether they are enrolled in a for-profit or public institution. Given that public 4-year institutions and private not-for-profit institutions have different student mixes and demographics than for-profit institutions, these institutions serve as poor benchmarks to the private for-profit institutions. The data presented here demonstrate that the appropriate comparables for the for-profit institutions are public 2-year institutions.

**Exhibit 4: Total Student Enrollment In Fall by Race/Ethnicity**  
(U.S. Degree-granting Institutions, 2006-07)



Source: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Table 227

**Who financed the costs of education in public and private for-profit postsecondary institutions?**

Based on detailed data published by NCES in the Digest of Education Statistics, we compiled the total costs of providing education to postsecondary students. The total costs include the education costs that are borne by students and by the local, state and federal governments, as shown in Exhibit 5. We also analyze the costs borne by other private parties.

For the academic year in 2006-07, annual prices for college tuition and required fees at public 2-year institutions amounted to \$2,133 per full-time equivalent student. In 2006-07, the tuition

and required fees paid by students at for-profit 2-year institutions were \$13,442 per full-time equivalent student.

**Exhibit 5: Costs of Providing Postsecondary Education, Per Full-time Equivalent Student**

(U.S. Degree-granting Institutions, 2006-07 in Constant 2007-08 Dollars)

		<b>Public 2-Year Institutions</b>	<b>For-profit 2-Year Institutions</b>
<b>Tuition and Required Fees Per Year</b>	[1]	\$2,133	\$13,442
(% of Total Costs Per Year)	[2]=[1]/[5]	18.2%	90.8%
<b>Government Grants and Contracts Per Year</b>	[3]	\$9,599	\$1,361
(% of Total Costs Per Year)	[4]=[3]/[5]	81.8%	9.2%
<b>Total Costs per Year</b>	[5]=[1]+[3]	\$11,732	\$14,803
Length of Program (in years)	[6]	2.0	2.0
<b>Total Costs For Completing the Program</b>		<b>\$23,464</b>	<b>\$29,606</b>

Sources: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Tables 352 and 357

The tuition and required fees are only part of the total cost of providing education. The federal, state and local governments also provide substantial direct funding to post-secondary institutions. The costs borne by taxpayers include grants and contracts for operating revenues, appropriations and non-operating grants for non-operating revenues, and capital appropriations. In 2006-07, public 2-year institutions received on average \$9,599 per full-time-equivalent student from government grants, contracts and appropriations, excluding federal direct student loans. That government funding accounted for 82% of the total costs for completing an associate degree in public 2-year institutions in 2006-07. Because public institutions receive substantial direct funding from the government entities, they charge lower tuitions and related fees than private institutions. The for-profit 2-year institutions received only \$1,361 per full-time-equivalent student from direct government funding in 2006-07. This covers only 9% of the total program costs. It is not surprising, therefore, that the students at the for-profit 2-year institutions pay higher tuition and fees because they bear most of the costs of education.

In total, the annual costs of providing postsecondary education to public 2-year institutions were \$11,732 per full-time equivalent student in 2006-07, as shown in Exhibit 5. With a program

length of 2 years, the total cost for completing an associate degree in public 2-year institutions is \$23,464. The taxpayers bear most of the education costs at the public institutions. The total education costs for a student to complete an associate degree at the for-profit 2-year institutions were \$29,606, as also shown in Exhibit 5. Unlike the public institutions, the students at the for-profit 2-year institutions fund over 90% of the total costs.

There are other education costs that are borne by the taxpayers and private third parties that are not included in our analysis. Some of these costs include tax benefits provided by the federal and state governments associated with private gift donations, property tax foregone by the local and state governments, and the state and federal income taxes paid by for-profit institutions which offset the costs borne by the taxpayers. A more detailed discussion of these costs is included in Appendix A.

### **Total Taxpayer Cost per Graduated Student from Public 2-year and For-Profit 2-year Institutions**

In this section, we present the total direct cost, not including any of those indirect costs discussed in Appendix A, borne by taxpayers per graduated student at public 2-year and for-profit 2-year institutions. This is a very conservative way to compare the institutions. The analysis is based on data provided by the DOE. As discussed earlier in this paper, the total government funding provided to public 2-year and for-profit 2-year institutions were \$9,599 and \$1,361 per full-time equivalent student, respectively, in 2006-07. The taxpayers thus bear an additional cost of \$8,238 (\$9,599 minus \$1,361) per full-time equivalent student at public 2-year institutions compared to the for-profit 2-year institutions.

Not all the students who received funding from the government graduated from the 2-year public institution they attended. Some students transferred to a 4-year institution before completing an associate degree while others dropped out of the public 2-year colleges. According to data provided by the DOE, 28.9% of students at public 2-year institutions transferred to a 4-year institution, with about one-third of those students completing an associate degree before the transfer. This means that 19.3% (2/3 of 28.9%) of the total students at community colleges transferred to a 4-year institution without graduating from the community

colleges. These students stayed at the community colleges for one to two years before their transfer.

The DOE data also shows that 20.3% of students (including one-third of the transferred students) at the community colleges graduated with an associate degree.<sup>3</sup> These students stayed at the community colleges for at least two years in order to complete the associate degree. The rest of the community college students either dropped out, exceeded the length deemed appropriate for graduation by the DOE, or transferred to a 4-year institution. Assuming these students only stayed at the community colleges for six months, we determine that a full-time equivalent student on average stays at the community colleges for approximately 1.0 year.

Not all community college students who transferred to a 4-year university without completing an associate degree graduate with a Bachelor degree. Data from the DOE shows that a 4-year public university has a graduation rate of 49.1% (for the 2001 starting cohort).<sup>4</sup> We believe this graduation rate is high for community college transfer students due to the fact that these students have a higher likelihood of being “non-traditional” students. Despite this fact, we use the 4-year public graduation rate of 49.1% in our analysis which we believe is a conservative assumption. Thus, 9.5% of total students at community colleges that transferred to a 4-year institution before completing an associate degree eventually graduated from the 4-year institution. Including these students in our calculation, the graduation rate of community colleges was 29.8% (20.3% graduated with an associate degree and 9.5% eventually graduated with a Bachelor degree from the 4-year institution). With a graduation rate of 29.8%, the total cost borne by taxpayers per graduated student is \$32,163 (\$9,572 total taxpayer cost per student divided by the graduation rate of 29.8%) for completing his associate degree at the community colleges. The calculations are shown in Exhibit 6.

It has been documented that public 2-year institutions have lower graduation rates than for-profit 2-year institutions. According to data provided by the DOE (for cohort year 2004),

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<sup>3</sup> Graduation percentage is based on the percent of students completing an associate degree within 150 percent of normal time (for 2004 starting cohort). Source: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Table 331

<sup>4</sup> Based on percent completing Bachelor degrees within 5 years after start. Source: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Table 331

the graduation rate of the for-profit 2-year institutions was 58.2%.<sup>5</sup> This is significantly higher than both, the graduation rate we calculated of 29.8% at the community colleges, and the DOE reported graduation rate of 20.3% at the community colleges. Note that the graduation rate for the for-profit 2-year institutions does not include any transferred students who did not complete an associate degree but eventually graduated with a Bachelor degree because such data is not readily available.

We follow the same procedure to calculate the total cost to taxpayers per graduated student for the for-profit 2-year institutions. By our calculations, the total cost to taxpayers for a graduated student at the for-profit 2-year institutions is only \$3,211. The calculations are shown in Exhibit 6.

The direct government funding provided to post-secondary institutions are actual out-of-pocket costs to the taxpayers. This is because neither the post-secondary institutions nor the students have any obligation to repay those direct government funding. The direct government funding is thus notably different from federal direct student loans. In the case of federal direct loans, the borrowers are obligated and expected to repay the loans in full to the government with interest. There is no cost (putting aside the administrative fees) for the taxpayers to provide direct student loans unless the borrowers default on those loans and eventually do not fully repay the loan balance. This is discussed in greater detail in the next section.

Ignoring the effect of defaults on direct student loans for the public and private for-profit institutions, the for-profit sector costs the taxpayers significantly less than the public institutions. The taxpayers paid **\$28,953** less in total cost to support a full-time equivalent graduated student attending a for-profit 2-year institution than at a public 2-year institution (total cost to taxpayers per graduated student of \$32,163 to public 2-year institutions minus \$3,211 to for-profit 2-year institutions) in 2006-07.

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<sup>5</sup> *Id.*

**Exhibit 6: Total Taxpayer Cost Per Graduated Student Completing the Program  
In Public and Private For-profit Institutions**

(U.S. Degree-granting Institutions, 2006-07 in constant 2007-08 dollars)

		Public 2-Year Institutions	For-profit 2-Year Institutions	Difference
		[A]	[B]	[B] minus [A]
<b>Government Grants and Contracts</b>	[1]	\$9,599	\$1,361	
Average Years In School (Including Transfers and Dropouts)	[2]	0.997	1.373	
<b>Total Taxpayer Cost Per Student Completing the Program</b>	[3]=[1]*[2]	\$9,572	\$1,869	
Graduation Rate of Students (Including Non-graduates)	[4]	29.8%	58.2%	
<b>Total Taxpayer Cost Per Graduated Student</b>	[5]=[3]/[4]	<b>\$32,163</b>	<b>\$3,211</b>	<b>(\$28,953)</b>

Sources: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Tables 352 and 357;  
Charles River Associates calculations.

*Notes:*

[2] Assumes graduated students stayed for 2 years; transferred students stayed for 1-2 years; and the rest of students stayed for 6 months only

[4] Based on graduation data provided by the U.S. Department of Education. Graduation rate for public 2-year institutions includes those students who transferred to a 4-year institution and eventually graduated with a Bachelor's degree. No transferred students are included at the for-profit 2-year institutions to compute the graduation rate.

## **Total Taxpayer Cost for Funding Federal Direct Loans**

Taxpayers also bear potential costs for funding the direct loans provided by the federal government to post-secondary students. A more detailed analysis of the federal direct loan program and the subsidy rate computed by the federal government on the direct loans is included in Appendix B. Because the interest rates charged by the federal government on the direct loans are higher than its borrowing rates, the federal government generates substantial income by making direct loans to students.

A loan is considered to be in default if the borrower fails to make a payment for 270 days (330 days if payments are due less frequently than each month). If a borrower defaults on a federal student loan, the obligation to repay cannot be discharged by filing bankruptcy under the current law. The government, through its various means, can collect the delinquent loans during the entire lifetime of the borrower. The government can utilize private collection agencies to collect the loans. It can also garnish wages and use the Treasury Offset Program to collect a portion of federal transfer payments that the delinquent borrowers receive (e.g. tax refunds or Social Security benefits).

Even when there is a loan default, the taxpayers may incur little cost if the federal government eventually recovers the loan principal and interest. According to the data published by the Office of Management and Budget (“OMB”) for the budget in fiscal year 2011, the recovery rate of all obligations under the FDLP programs is estimated to be 110.60 for a loan principal of 100. This means that the federal government is expected to fully recover the loan principal and receive an interest of \$0.11 for each dollar of direct loan made. OMB did not break down the recovery rate between not-for-profit and for-profit institutions.

In October 2000, the U.S. Government Accountability Office (“GAO”) conducted a detailed study on the default rates for FDLP loans based on the 1998 cohort default data. The GAO study shows that the student loan default rates of 2-year institutions (both for-profit and not-for-profit) were twice as high as the public 4-year institutions. It concludes that “[T]he higher default rates for borrowers attending [public] 2-year and proprietary schools are indicative of

the higher risk of default that has historically been associated with these borrowers.”<sup>6</sup> Past research conducted by GAO shows that default rate differences were related to characteristics such as the student’s academic preparation for higher education or the family’s socioeconomic status.<sup>7</sup> The GAO study also found that the federal direct loan default rate at the public 2-year institutions (at 12.5%) was comparable to that experienced by the proprietary schools (at 10.2%).

The DOE recently published updated default rates for the not-for-profit and for-profit institutions. The default rates are measured based on the cohort default rates on certain Federal Family Education Loan (FFEL) and FDLP loans for cohort years 2003 to 2007. The cohort default rate is the percentage of borrowers who enter repayment on certain federal loans during a particular federal fiscal year, October 1 to September 30, and default (or meet other specified conditions) prior to the end of the next fiscal year. The DOE also measured the cumulative lifetime default rate for loans originated by cohort year 2003 to 2007. A cumulative lifetime default rate is the percentage of loans that enter repayment in the FFEL and FDLP for a particular federal fiscal year and have defaulted through the end of the most recent federal fiscal year. Unlike the cohort default rate, which reflects a two-year indicator period, the cumulative lifetime default rate reflects the risk of default throughout the life of the loan. The DOE measured the default occurring from the time the loan entered repayment through September 30, 2009.

According to the DOE data, the cohort default rates for the for-profit 2-year and public 2-year institutions are comparable. For instance, for federal loans originated in cohort year 2003, the default rate is 8.0% for the for-profit 2-year institutions, as compared with the default rate of 7.6% for public 2-year institutions. The cohort default rates as measured by the DOE are shown in Exhibit 7A. The DOE only provided the cumulative default rates for the for-profit institutions (4-year and 2-year institutions) on an aggregate basis. For the federal loans originated in cohort year 2003, the cumulative lifetime default rate for the for-profit institutions

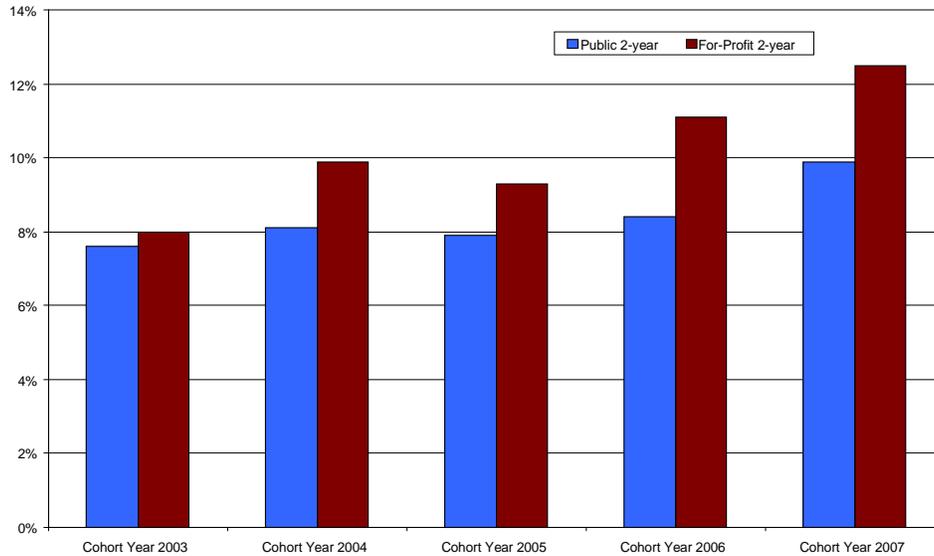
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<sup>6</sup> GAO, Student Loans: Direct Loan Default Rates, 10/17/2000, p. 5

<sup>7</sup> *Id.*, p. 11. See also, GAO, Student Loans: Characteristics of Students and Default Rates at Historically Black Colleges and Universities, 4/9/1998.

is 26.0%. This is slightly higher than the cumulative lifetime default rate of 21.4% for public 2-year institutions. The cumulative default rates are shown in Exhibit 7B. Overall, the default rates between the for-profit and public 2-year institutions are comparable. This is consistent with the results of the GAO study discussed above.

Exhibit 7A: Cohort Default Rate of For-profit 2-Year and Public 2-Year Institutions\*



\*Based on proprietary 2-3 year and public 2-3 year institutions as published by the U.S. Department of Education

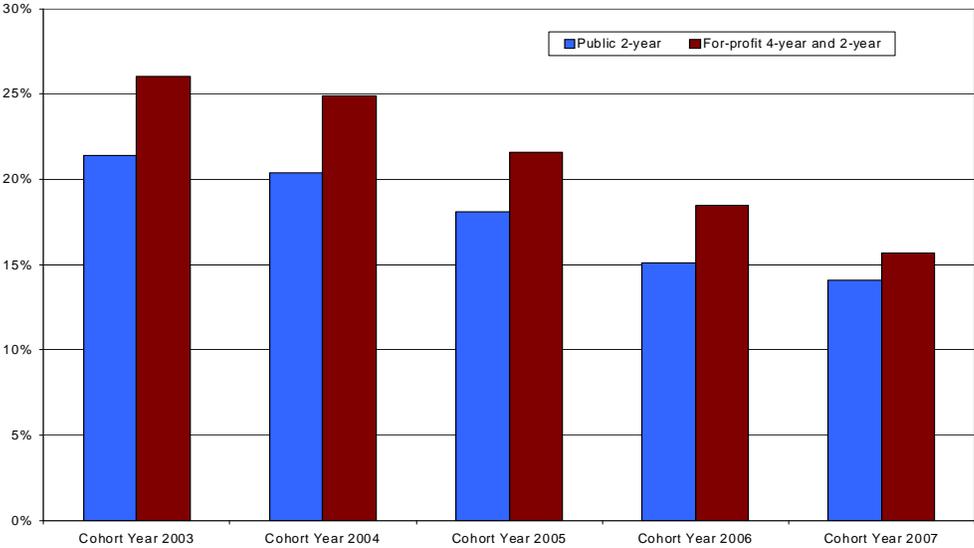
Source: The Department of Education, *Default Rates for Cohort Years 2003-2007*, December 14, 2009.

Note: A cohort default rate is the percentage of borrowers who enter repayment on certain Federal Family Education Loan (FFEL) Program or William D. Ford Federal Direct Loan (Direct Loan) Program loans during a particular federal fiscal year, October 1 to September 30, and default or meet other specified conditions prior to the end of the next fiscal year.

Based on data published by the DOE, we determine the average amount of direct loans provided by the federal government to students at the for-profit institutions (2-year and above) to be \$6,709 per full-time equivalent student in 2007-08. If it is assumed that these loans experience a cumulative lifetime default rate of 26.0%, then the expected amount of defaulted loan will be \$1,744 (\$6,709 direct loans multiplied by the cumulative default rate of 26.0%) per full-time equivalent student per year. Assuming there is no recovery by the federal government on these defaulted loans, the expected defaulted loan amount of \$1,744 represents a direct cost borne by the taxpayers to the student in one year. Based on an average stay of 1.37 years at school (as discussed in the last section), the total cost to taxpayers will be \$2,395 (\$1,744 total cost to taxpayers per year multiply by 1.37 years) per full-time equivalent student during his entire stay

at the for-profit institutions. Given a graduation rate of 58.2% for the for-profit 2-year institutions (as discussed in the last section), we calculate the total cost to taxpayers for federal direct loans to be \$4,115 per graduated student (\$2,395 per full-time equivalent student divided by the graduation rate of 58.2%). The calculations are shown in Exhibit 8.

**Exhibit 7B: Cumulative Lifetime Default Rates of For-profit and Public 2-Year Institutions**



Source: The Department of Education, *Default Rates for Cohort Years 2003-2007*, December 14, 2009.  
 Note: A cumulative lifetime default rate is a percentage of loans that enter repayment in the FFEL and Direct Loan Programs for a particular federal fiscal year and have defaulted through the end of the most recent federal fiscal year. Unlike the cohort default rate, which is utilized as an administrative tool for schools and currently reflects a two-year indicator period, the cumulative lifetime default rate is a performance tool focused on the risk of default throughout the life of the loan. This rate will be updated and published annually.

Note that the total cost to taxpayers of \$4,115 per graduated student for the for-profit institutions is based on an assumed 0% recovery rate for the defaulted federal direct loans. This assumption is conservative and highly unlikely to be consistent with the actual loan recovery experience. By increasing the recovery rate to 60%, the total cost to taxpayers for providing federal direct loans is only \$1,646 per graduated student for the for-profit institutions.

**Exhibit 8: Total Taxpayer Cost For Funding Federal Direct Loans  
at Public 2-Year and Private For-profit Institutions**

(U.S. Degree-granting Institutions, 2007-08)

		Public 2-Year Institutions	For-profit Institutions (2-year and Above)	Difference
		[A]	[B]	[B] minus [A]
Federal Loans to Students Per Year (for students receiving loans)	[1]	\$4,600	\$7,230	
% of Full-time Students Receiving Federal Loans	[2]	21.5%	92.8%	
<b>Federal Loans Per Full-time Equivalent Student Per Year</b>	[3]=[1]*[2]	<b>\$989</b>	<b>\$6,709</b>	
Cumulative Lifetime Default Rate (based on cohort year 2003)	[4]	21.4%	26.0%	
Expected Loan Defaults Per Full-time Equivalent Student Per Year	[5]=[3]*[4]	\$212	\$1,744	
Assumed Recovery Rate of Defaulted Loans	[6]	0%	0%	
<b>Total Taxpayer Cost For Funding Federal Direct Loans Per Student Per Year</b>	[7]=[5]*(1-[6])	<b>\$212</b>	<b>\$1,744</b>	
Average Years In School (Including Transfers and Dropouts)	[8]	0.997	1.373	
<b>Total Taxpayer Cost For Funding Federal Direct Loans Per Student For Completing the Program</b>	[9]=[7]*[8]	\$211	\$2,395	
Graduation Rate of Students	[10]	29.8%	58.2%	
<b>Total Taxpayer Cost For Funding Federal Direct Loans Per Graduated Student</b>	[11]=[9]/[10]	<b>\$709</b>	<b>\$4,115</b>	<b>\$3,406</b>
Total Taxpayer Cost For Funding Federal Direct Loans Per Graduated Student (Assuming a 60% recovery rate for defaulted loans)		\$284	\$1,646	\$1,362

[10] For public 2-year institutions, graduation rate includes those students who were transferred to a 4-year institution and graduated with a Bachelor's degree, even though they did not complete an Associate's degree at the public 2-year institutions.

Sources: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Tables 331, 343 and 344;  
Cumulative lifetime default rates as provided by the Department of Education; Charles River Associates calculations.

Lastly, we follow the same procedure to compute the total taxpayer cost for providing federal direct loans to the public 2-year institutions. According to our calculations, the total taxpayer cost for providing federal direct loans to students at public 2-year institutions was \$709 per graduated student in 2007-08. The calculations are also shown in Exhibit 8. Thus, the difference in the total taxpayer cost for providing federal direct loans between for-profit institutions and public 2-year institutions is **\$3,406** (\$4,115 minus \$709) per graduated student. This is significantly less than the higher direct government funding of **\$28,953** per graduated student that was provided by the local, state and federal governments to the public 2-year institutions than to the for-profit 2-year institutions as discussed in the last section. The taxpayers saved **\$25,546** (\$28,953 minus \$3,406) per graduated student by providing post-secondary education through for-profit 2-year institutions than public 2-year institutions.

## Appendix A

There are other education costs that are borne by taxpayers and private third parties that we did not include in our analysis. One added cost is foregone property tax. While for-profit institutions are required to pay property taxes on their land, infrastructure, buildings and improvements, not-for-profit institutions do not pay such taxes. For example, the University of California, Los Angeles and Los Angeles Community College District reported a book value of \$18.2 billion and \$584 million, respectively, in land, infrastructure and buildings for 2007. Assuming a 1% property tax rate, they would have to pay about \$850 and \$60, respectively, in property taxes per each enrolled student, by our calculations. The foregone property tax represents an indirect cost borne by the taxpayers to fund not-for-profit institutions.

Many post-secondary institutions also receive private gifts and generate investment income from these gifts to fund their capital budgets. Capital outlay funding is typically separate from operating budgets because of the different revenue sources and the longer horizon for amortizing costs. Many discussions of higher education costs, in particular cost benchmarking between institutions, focus on operating budgets while excluding capital outlay appropriations.

The practice of excluding capital outlay funding understates the cost to taxpayers for the post-secondary institutions. For instance, in the case of private gift donations, the donors typically receive a tax benefit from the federal and state government. Thus, the taxpayers indirectly subsidize the post-secondary institutions by foregoing the taxes that the state and federal governments would have received from the donors. In 2006-07 (last year with available data), the public institutions and private not-for-profit institutions received \$5.6 billion and \$20.2 billion, respectively, in private gifts.<sup>8</sup> In contrast, the for-profit institutions received only a tiny amount of \$3.7 million in private gifts.<sup>9</sup> Given that the not-for-profit institutions received most of the private gift donations, they received substantial indirect benefits from the taxpayers.

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<sup>8</sup> Source: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Tables 352 and 355

<sup>9</sup> Source: U.S. Department of Education, National Center For Education Statistics, *Digest of Education Statistics 2009*, Table 357

For the for-profit institutions, the taxpayers also receive substantial benefits associated with the state and federal income taxes generated by these institutions. Based on financial data published by the publicly-traded for-profit institutions, the average combined state and federal income tax paid by these institutions was \$728 per student in 2008, as shown in Exhibit 9. Unlike the for-profit institutions, the not-for-profit institutions do not have to pay any state or federal income tax.

**Exhibit 9: Income Taxes Paid to Government Per Student By Private For-Profit Institutions**

\$ in millions

Company	Ticker	Taxes		Enrollment		Tax Per Student	
		12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Strayer Education Inc.	STRA	\$ 68.7	\$ 50.6	55,106	45,697	\$ 1,246	\$ 1,107
Capella Education Co.	CPLA	23.6	15.4	33,982	26,883	696	572
Universal Technical Institute Inc.	UTI	12.1	3.0	17,741	15,143	682	201
DeVry, Inc.	DV	101.9	55.8	80,251	67,235	1,270	831
Education Management Corporation	EDMC	62.7	45.5	113,964	97,128	551	468
Career Education Corp.	CECO	78.7	38.5	105,300	87,700	747	439
Lincoln Educational Services Corporation	LINC	34.9	13.3	29,340	21,667	1,188	616
Apollo Group Inc.	APOL	466.6	347.3	420,700	345,300	1,109	1,006
ITT Educational Services Inc.	ESI	191.1	125.9	80,766	61,983	2,366	2,030
Corinthian Colleges Inc.	COCO	80	20	76,165	67,270	1,048	293
Grand Canyon Education, Inc.	LOPE	18	4	37,709	24,636	477	156
American Public Education, Inc.	APEI	16	10	12,060	6,730	1,328	1,517
Bridgepoint Education, Inc.	BPI	35	7	53,688	31,558	654	224
		1,189	736	1,116,772	898,930	<b>1,028</b>	<b>728</b>

Source: CapitalIQ database, Legg Mason equity research

## Appendix B

A prominent student loan program provided by the federal government is the Federal Direct Loan Program (“FDLP”). Under FDLP, commonly known as the direct loan programs, students or their parents borrow money directly from the federal government through the school attended by the student. The first FDLP loans were made in the fourth quarter of fiscal year 1994. The FDLP program is administered by the DOE. The FDLP loans offer substantial financial benefits to borrowers because of their favorable terms, including lower interest rates than private student loans, flexibility of repayment options, and deferment of debt service under certain circumstances. For direct unsubsidized loans, the interest rate is fixed at 6.8%.<sup>10</sup>

Under the Federal Credit Reform Act (“FCRA”) of 1990 and subsequent legislation, the cost of a federal loan is the net present value of all future cash flows associated with the loans made. FCRA requires the present values to be calculated by discounting the expected cash flows at the borrowing rates of the federal government (i.e., interest rates on Treasury securities). The cash flows for the loans do not include federal government’s administrative costs for operating the loan programs.

In its research report published in November 2005, the Congressional Budget Office (“CBO”) calculated the subsidy rates for the federal direct loans. CBO determined the subsidy rate of federal direct loans by discounting the cash flows to the year of the loan’s disbursement to reflect the time value of money. For FDLP, there are two cash flows at the time of loan’s disbursement: the disbursement of the loan to the individual borrower, and the loan origination fees of 1.5% that are charged by the government to the borrower. The cash flows over the life of the loan are based on the repayments of loan principal and interest by the borrower to the government. The repayment plan selected by a borrower has a large impact on the length and timing of the cash flows.

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<sup>10</sup> Borrowers of direct unsubsidized loans are not required to demonstrate financial need. Direct subsidized loans are for students with financial need. The interest rate of direct subsidized loans for undergraduates is to be fixed at 4.5% if the first disbursement is between July 1, 2010 and June 30, 2010. The interest rate of direct subsidized loans for graduates and professional degree students are fixed at 6.8%.

In its study, CBO calculated a subsidy rate of -2.1% based on a hypothetical \$3,000 direct loan that follows a standard 10-year plan. The negative subsidy rate indicates that the federal government records a budgetary savings of \$0.02 for each dollar of direct loan made. The federal government is expected to make money on the direct loans because the interest rates charged by the federal government on the direct loan are higher than the Treasury rates. In the hypothetical example used by CBO, the loan rate was about 6.5% whereas the discount rate was only 5.3%. Given today's low Treasury rates, the subsidy rate will be higher. For instance, as of September 3, 2010, the interest rate on 10-year Treasury securities was only 2.72%. Based on the CBO hypothetical example and a loan rate of 6.8%, we calculate the subsidy rate to be -20.3% as shown in Exhibit 10A. This shows that the government generates substantial income by making direct loans to students, assuming there is no default on the loan.

**Exhibit 10A: Subsidy Rate for a Hypothetical \$3,000 Loan Under the Direct Loan Program**

Discount Rate	2.72%													
Loan Rate	6.80%													
<b>Subsidy Rate:</b>	<b>-20.3%</b>													
		<b>Nominal Cash Flows</b>											<b>Present Value of</b>	
		2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	<b>Total Cash</b>
<hr/>														
Disbursement														
[1]	Principal disbursement	3,000												3,000
[2]	Borrower's origination fee	(45)												(45)
Repayment														
[3]	Principal			(219)	(234)	(250)	(267)	(285)	(305)	(325)	(347)	(371)	(396)	(2,491)
[4]	Interest			(204)	(189)	(173)	(156)	(138)	(119)	(98)	(76)	(52)	(27)	(1,074)
<b>[5]</b>	<b>Total Costs</b>	2,955		(423)	(423)	(423)	(423)	(423)	(423)	(423)	(423)	(423)	(423)	(610)

Sources:  
 On-the-run 10-year Treasury rate from [www.ustreas.gov](http://www.ustreas.gov)  
 A CBO Paper, *Subsidy Estimates for Guaranteed and Direct Student Loans*, November 2005.

Note:  
 Discount rate is based on on-the-run 10-year Treasury rate as of 9/3/2010.

A loan is considered to be in default if the borrower fails to make a payment for 270 days (330 days if payments are due less frequently than each month). If a borrower defaults on a federal student loan, the obligation to repay cannot be discharged by filing bankruptcy under the current law. The government, through its various means, can collect the delinquent loans during the entire lifetime of the borrower. The government can utilize private collection agencies to collect the loans. It can also garnish wages and use the Treasury Offset Program to collect a

portion of federal transfer payments that the delinquent borrowers receive (e.g. tax refunds or Social Security benefits).

Even when there is a loan default, the net cost to the federal government is small if the government eventually recovers the loan principal and interest. This is because the federal government only loses the time of value of money on the repayment of loan principal and interest. To illustrate this point, we re-calculate the subsidy rate based on the hypothetical example discussed above but assume that the borrower delays the loan payments by two years. Under this scenario, the subsidy rate is calculated to be -14.1%, as shown in Exhibit 10B. The negative subsidy rate shows that the government still makes money on the loan on a net present value basis. Thus, as long as the federal government recovers its loan principal and interest, loan defaults are not costly to the federal government. According to the data published by the Office of Management and Budget (“OMB”) for the budget in fiscal year 2011, the recovery rate of all obligations under the FDLP programs is estimated to be 110.60. This means that the government is expected to fully recover the loan principal and an interest of \$0.11 for each dollar of direct loan made. OMB did not break down the recovery rate between not-for-profit and for-profit institutions.

**Exhibit 10B: Subsidy Rate for a Hypothetical \$3,000 Loan Under the Direct Loan Program**

(Assumes a delay of payment by 2 years)

Discount Rate	2.72%
Loan Rate	6.80%
<b>Subsidy Rate:</b>	<b>-14.1%</b>

		Nominal Cash Flows												Present Value		
		2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	of Total Cash Flows
Disbursement																
[1]	Principal disbursement	3,000														3,000
[2]	Borrower's origination fee	(45)														(45)
Repayment																
[3]	Principal					(219)	(234)	(250)	(267)	(285)	(305)	(325)	(347)	(371)	(396)	(2,361)
[4]	Interest					(204)	(189)	(173)	(156)	(138)	(119)	(98)	(76)	(52)	(27)	(1,018)
[5]	<b>Total Costs</b>	2,955				(423)	(423)	(423)	(423)	(423)	(423)	(423)	(423)	(423)	(423)	<b>(424)</b>

Sources:

On-the-run 10-year Treasury rate from [www.ustreas.gov](http://www.ustreas.gov)  
A CBO Paper, *Subsidy Estimates for Guaranteed and Direct Student Loans*, November 2005.

Note:

Discount rate is based on on-the-run 10-year Treasury rate as of 9/3/2010.