Emerging Risk?: An Overview of Growth, Spending, Student Debt and Unanswered Questions in For-Profit Higher Education

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INTRODUCTION

Postsecondary education is a gateway to the middle class for millions of Americans. It equips people with the knowledge and skills they need to perform professional work and compete in the global economy. To increase access to postsecondary education, the Federal government has provided grants and loans to students for more than half a century, steadily increasing its investment nearly every year. In fiscal year 2010, Federal funding for financial aid to postsecondary students is expected to total $145 billion.¹

The Federal investment in higher education is a solid investment in our future. Postsecondary education results in benefits to the individual, including greater wealth and better health, and also to the nation in the form of a more engaged citizenry and a more skilled workforce.

However, the United States is playing catch-up. Once first in the world in postsecondary attainment, the United States now ranks 10th in the percentage of people with a college degree.² President Obama has set the goal of making the United States, once again, first in the world in the proportion of college graduates by 2020. To this end, over the last three years Congress has taken steps to make college more accessible and affordable by substantially increasing student borrowing limits, recently committing $36 billion in mandatory Pell grant funding over the next 10 years included in the Health Care and Education Reconciliation Act of 2010, through $17 billion in discretionary funding through the American Recovery and Reinvestment Act of 2009 and annual discretionary funding, which in FY2010 was $17.56 billion.

For-profit schools are an important part of the mix of postsecondary institutions. They increase access to higher education by providing needed capacity as well as innovative options that can make it easier for students to complete their postsecondary education while managing work and family obligations. Enrollment in for-profit schools has grown dramatically over the past decade and, each year has seen a larger share of Federal student aid dollars flowing to these schools. Congress and the U. S. Department of Education have a duty to ensure that for-profit schools spend these Federal dollars efficiently and effectively.

Evidence suggests that for-profit schools charge higher tuition than comparable public schools, spend a large share of revenues on expenses unrelated to teaching, experience high dropout rates, and, in some cases, employ abusive recruiting and debt-management practices. What distinguishes for-profit schools from public and non-profit private institutions is that they have an obligation to maximize profits for their shareholders. Indeed, securities law sanctifies the notion that each corporation must act in the interest of its shareholders. However, this imperative could conflict with the objective of Federal student aid programs, which is to increase access to a quality higher education. This evidence, and the potential conflicts underlying it, points to the need for rigorous government oversight and prudent regulation to safeguard the investments of taxpayers and students.

This report draws on publicly available information to shed light on the scope of the Federal investment


in for-profit schools and how these schools are using those taxpayer dollars. It also seeks to identify gaps in available information about enrollment, student performance, and loan debt and repayment – gaps that impede effective oversight.

GROWTH AND CHANGE IN ENROLLMENT

Over the last 10 years, there has been steady growth in student enrollment across all types of postsecondary education institutions. Between 1998 and 2008, enrollment at institutions of higher education increased 31 percent, from 14.9 million students to 19.6 million students. For-profit schools have expanded much faster, increasing enrollment 225 percent over the same period.3

Much of this growth has been concentrated in schools run by publicly traded companies. Currently, the 14 publicly traded companies in this field have combined enrollment of 1.4 million students, up from 8 companies that enrolled 199,584 students in 1998.4 The largest for-profit school reports current enrollment of 458,600, more than the undergraduate enrollment of the entire Big Ten conference.5

The trend toward educating students predominantly online is transforming for-profit schools. This change was facilitated by the 2005 Congressional repeal of the “50 percent rule” which previously required that schools furnish no more than half their courses online and have no more than half their students enrolled in distance-learning courses.6 Of the 14 publicly traded schools, at least 7 currently have more than 50% of their students in exclusively online curriculum.7 Since that repeal, some for-profit companies have purchased small regionally accredited bricks-and-mortar schools and transformed them into huge entities with primarily virtual curricula, while also avoiding the time and cost of earning regional accreditation. For example, in 2005 one company purchased a small, regionally-accredited, religious school with an enrollment of 332 students on campus. Five years later, with the same accreditation, that same company

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3 Majority staff analysis of U.S. Department of Education data.

4 Majority staff calculation of FY2010 quarterly filings with the U.S. Securities and Exchange Commission; Majority staff calculation of FY1998 quarterly and annual filings with the U.S. Securities and Exchange Commission.

5 School #1 FY2010 quarterly filings with the U.S. Securities and Exchange Commission; Majority staff compilation of Fall 2009 undergraduate enrollment from Big Ten school websites.


7 Four of the fourteen schools have more than 98% of students online, while 3 schools have more than 50% of students in online courses. See FY2009 Form 10k filings with the U.S. Securities and Exchange Commission for schools ranked 3, 7, 8, 9, 10, 11 and 12 by enrollment.
has more than 65,000 students, 99 percent of whom attend class solely online.\(^8\)

**GROWTH IN FEDERAL STUDENT AID TO THE FOR-PROFIT SECTOR**

The share of Federal aid flowing to for-profit schools is growing rapidly, and is actually outpacing growth in enrollment, meaning not just that there are more students enrolling in the schools but that the schools are receiving more Federal money per student.

The Federal government offers loans to all students regardless of their income. For students with financial need, it helps pay for higher education using two key tools authorized by Title IV of the Higher Education Act: Pell grants in an amount up to $5,350 per year for FY2010, and Stafford loans of up to $12,500 per year, which students repay after leaving school. This financial aid is intended for the benefit of the student. But, as a practical matter, aside from education-related expenses, student aid disbursements go directly to the student’s school.

According to U. S. Department of Education data, $4.3 billion in Pell grants and $19.6 billion in Federal loans flowed to for-profit schools in 2008-09, approximately double the share in 1999-2000.\(^9\)

Pell grants in particular warrant careful management. Over the last several years Congress has made hard choices to devote greater federal resources to the Pell program over other domestic priorities. Between 1999 and 2009, Congressional allocations for Pell enabled the program to grow significantly from $7.2 billion in 1999 to $18.3 billion in 2009. During that same period, the Pell Grant maximum award increased by 51 percent – increasing from $3,125 to $4,731 while the number of Pell recipients increased from 3.8 million to 6.2 million. While all sectors received higher levels of Pell funding as a result of these increases, the for-profit schools enjoyed a disproportionate share of the increase. In 2009, for profit colleges receive almost one quarter of all Pell Grants – up from just 13% in 1999.\(^{10}\)

Federal Pell grants and Stafford loans, together with aid from smaller Title IV programs, make up the lion’s share of for-profit schools’ revenues, and the share continues to grow. According to company

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8 School 8 FY2009 annual filing with the U.S. Securities and Exchange Commission; School 8 FY2010 quarterly filing with the U.S. Securities and Exchange Commission.

9 Staff calculation of data provided by U.S. Department of Education

financial reports, in 2002, Title IV government dollars accounted for on average 62.9 percent of revenues at the five largest for-profit schools. By 2009, the same companies reported that Title IV dollars made up an average 77.4 percent of their revenue.11

However, the actual share of Federal dollars received by the schools is even higher. For purposes of revenue calculation, Federal law permits the schools to temporarily exclude the recent $2,000 annual increase in undergraduate Stafford loans for money disbursed after June 2008 and before July 2011.12 One for-profit school reported that Title IV dollars make up 86 percent of its revenues this year, but acknowledged that the excluded loan increases would add another one-half to three percentage points.13 A second school told investors that, with the recent increase in Stafford loans, Title IV dollars account for 88.9 percent of its revenues though the reported figure is 81.3 percent.14 Further, other forms of government aid – including Department of Defense, Department of Veterans Affairs and state programs – add to the share of public funds that for-profit schools receive.

While for-profit schools enroll close to 10 percent of all higher education students, they receive approximately 23 percent of Title IV funds15. They can collect this outsized share of Title IV dollars because they actively recruit primarily low-income students.

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11 In 2009, the top 5 publicly traded schools by enrollment had revenues that consisted of the following percentages of Title IV dollars, excluding the Stafford loan increases: School 1: 86 percent; School 2: 70 percent; School 4: 80 percent; School 5: 81 percent; School 6: 70 percent. If the Stafford loan increases were included the shares could be as high as 83 percent.

12 The Ensuring Continued Access to Student Loans Act of 2008 increased the amount of Stafford loans to undergraduates by $2,000, but allowed for-profit schools to exclude the increase from calculations of “the 90/10 rule” through mid 2011. The 90/10 rule provides that in order to remain eligible for Title IV aid, for-profit schools must have revenue of less than 90 percent from Title IV.

13 School 1 Q4 Earnings Conference Call, 10/27/09

14 School 5 FY2009 annual filing with the U.S. Securities and Exchange Commission.

15 Majority staff analysis of U.S. Department of Education data.
GROWING PROFITS

As these schools have increased their percentage of revenue from Federal student aid, for-profit education companies have become increasingly profitable. The average operating profit in FY2005 among publicly traded for-profit higher education companies was $127 million. The same number in FY2009 was $229 million, an increase of 81 percent.\(^\text{16}\)

For-profit schools have significant operating profit margins among companies listed on U.S. stock exchanges. For FY2009, one company reported an operating profit of $489 million on revenues of $1.3 billion, a 37 percent margin. By comparison, this margin was more than triple that of Raytheon, and double that of Apple\(^\text{17}\).

To satisfy shareholders, publicly traded schools must generate higher revenues while keeping down costs, including teaching costs. They do this by raising tuition and/or increasing the number of enrolled students, which in turn will increase the amount of federal student aid dollars flowing to the schools. With for-profit schools receiving more Title IV dollars every year, one area warranting inquiry is how they spend this extra Federal money, whether the increased revenue is used to bolster profits.

SPENDING BY THE FOR-PROFIT SECTOR

Because Title IV aid is technically provided to students, the Federal government places no restrictions on how revenue from Title IV student aid may be used by schools. There is no requirement that a school devote any portion of Title IV dollars to education.

To recruit new students, some schools spend heavily on television advertisements, billboards, phone solicitation, and web marketing. An analysis of the eight publicly traded schools that break out expense categories shows that, on average, they spend 50.2 percent of costs on expenses classified as education, 31 percent on recruiting and marketing, and 15.7 percent on undefined administrative expenses.\(^\text{18}\)

\(^{16}\) Company FY2005 annual filings with the U.S. Securities and Exchange Commission; Company FY2009 annual filings with the U.S. Securities and Exchange Commission.

\(^{17}\) School 6 FY2009 annual filing with the U.S. Securities and Exchange Commission; Raytheon FY2009 annual filing with the U.S. Securities and Exchange Commission; Apple FY2009 annual filing with the U.S. Securities and Exchange Commission.

\(^{18}\) School 1, School 4, School 5, School 8, School 9, School 10, School 11, School 12 FY2009 annual filings with the U.S. Securities and Exchange Commission.
Among publicly traded for-profit schools, spending on education ranges from 32 percent to 63 percent of costs. At exclusively on-line schools, the percentage spent on education is even lower.

Moreover, the amount that some for-profit schools spend on educating students is shrinking. One school reduced spending on education from 48 percent of costs in 2004 to 40 percent in 2009. A second school reduced spending on education from 37 percent of costs in 2006 to 32 percent in 2009. At least one school spent more on marketing and recruiting than on education, and another spent just one percent more on education than marketing and recruiting. At the same time numerous accounts detail marketing and recruiting practices that are sometimes overzealous or misleading.

For-profit schools’ expenditures on marketing and recruitment relative to the spending on education raise questions about whether sufficient resources are being devoted to ensuring that students receive a quality education that results in increased job opportunities or higher income.

STUDENT OUTCOMES

Given the growing Federal investment in for-profit higher education, and considering their growing profitability, for-profit schools should be able to demonstrate significant positive outcomes for students. However, while publicly available information offers some transparency as to the revenue and expenditures

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19 School 2, School 5 and School 8 FY2009 annual filings with the U.S. Securities and Exchange Commission.
21 School 8 FY2009 annual filing with the Securities and Exchange Commission.
22 School 8 and School 11 FY2009 annual filings with the Securities and Exchange Commission.
of for-profit schools, it is more difficult to ascertain how students attending and graduating from these schools are faring.

For-profit schools that receive Federal financial aid are required to report graduation rates to the U. S. Department of Education. By regulation, schools that advertise job placement rates as a means of attracting students are required to make available to prospective students the most recent job placement and graduation rates. However, there is wide variation in the quality of this information. All data is self-reported, with no auditing mechanism in place to validate accuracy outside of the opaque accreditation process.

While for-profit schools report graduation rates (sometimes called “completion rates” to encompass certificate programs) to the U. S. Department of Education, this data is self-reported and only captures first-time, full-time enrolled students. Considering the large number of for-profit college students who attend part-time, or who have previous college experience, a very significant share of enrolled students fall outside this reporting requirement.

With regard to job placement data, there is no agreed-upon definition of how placement in a relevant field is calculated. For example, a restaurant dishwasher or even a janitor might be considered a “placement” by a culinary school. Additionally, while for-profit schools must report placement to accrediting agencies, the agencies are not required to disclose these standards or make placement data available to the public or the U.S. Department of Education, and do not use consistent standards.

![Over 500,000 Students Departed 4 Schools](chart.png)

Source: School 1, School 4, School 5, School 6 FY2009 annual filings with the Securities and Exchange Commission. Department students are calculated by adding beginning enrollment to new students and subtracting ending enrollment.
What scant information is available from company documents reveals a disturbing trend: large numbers of students are departing for-profit schools each year. For the four schools that disclose detailed enrollment numbers, an estimate of the number of students graduating or dropping out each year can be calculated by adding the number of new students to the number of continuing students and subtracting year-end enrollment. However, there is no way to tell what portion of these students graduated, transferred or dropped out.

Using this methodology, it appears that 540,820 out of a total enrollment of 589,505 left the four schools in 2009. While an unknown number of these departing students completed degrees or certificates, it seems likely that a significant portion also dropped out of the schools.24

Three of the four schools enrolled more new students over the course of the year than the total number of students at the beginning of the year. One school started the reporting period with 62,000 students, enrolled 117,000 new students, but ended with just 86,000 students enrolled.25 Understanding what portion of these students is succeeding or failing to complete their degrees is critical to assessing the value of the Federal investment.

INCREASES IN DEBT AND DEFAULT

One way to evaluate whether students at these schools are receiving an adequate education is to see if they are able to repay the money they borrow to attend school. As college costs continue to rise, more students are borrowing to pay for school, and they are taking out larger loans. This is true across all sectors of higher education, but students at for-profit institutions are more likely to borrow and borrow larger loan amounts than their peers at other types of institutions.26 On average, for-profit schools are more expensive to attend than community colleges or public four year schools, and they enroll many low-income students who rely almost entirely on loans and Pell Grants to pay tuition. Average annual tuition at a for-profit school was about $14,000 in 2009, while tuition at community college averaged about $2,500

24 All four schools offer Associates and Bachelors degree programs. Three also offer shorter duration certificate programs.

25 School 5 FY2009 annual filings with the Securities and Exchange Commission.

and averaged $7,000 for in-state students at four-year public colleges.²⁷

According to U. S. Department of Education data, 96 percent of for-profit students who graduated in 2008 took out student loans. Twenty-four percent of 2008 graduates took out Federal loans in excess of $40,000.²⁸ These rates are higher than at private non-profit or public schools.

One of the consequences of increased student borrowing is an increase in the number of defaults. The available information on default rates paints a bleak picture. While macroeconomic conditions can affect student loan default rates, persistent high default rates raise the question of whether students are receiving educational value sufficient to allow them to afford the debt they incur. Students who cannot pay their loans face punitive fees and higher interest rates. Moreover, in most cases, bankruptcy law prohibits a student borrower from discharging a student loan; the loan follows a borrower for the rest of his or her life.

In December 2009, the U. S. Department of Education released a report on “Three-Year Cohort Default Rates” that examined the percentage of students who defaulted on their Federal student loans within three years of leaving school. The chart below depicts the percentage of students who default on their Federal student loans within three years of leaving school. It divides students up by sector and the highest degree offered at their institution. The U. S. Department of Education data clearly shows higher default rates for students who attend for-profit schools compared with those attending public or non-profit schools.

Most of the data and analysis on student loan debt and defaults measure the borrowing and repayment levels of students enrolled at least five years ago. For example, the most recent loan debt numbers for graduates come from the 2007-8 National Postsecondary Student Aid Survey. Bachelor’s degree recipients measured in that study enrolled in 2004. Similarly, cohort default rates measure students who entered repayment more than three years ago, but enrolled at least two years before that (in the case of A.A. recipients).

The consequence of this data lag is that key indicators of debt, default and government risk do little to pick up rapid changes in student loan utilization by students or schools. In 2003-4 the U. S. Department of

²⁷ College Board, Trends in College Pricing 2009

Education made $45 billion in Stafford Loans. Just six years later they made $63 billion in loans, a 40% increase.\textsuperscript{29} How schools are packaging those loans, and how students are borrowing will have a significant effect on the risk of the Federal government’s investment in student loans.

The U. S. Department of Education’s Inspector General raised questions about the accuracy of cohort default rates to measure the full scope of student debt repayment. In particular, the Inspector General was concerned that the short window (two years at the time, now three years) and the treatment of loan forbearances and deferments obscured the amount of Federal dollars at risk. In a 2003 report, the Inspector General recommended the U. S. Department of Education publish lifetime loan cohort default rates to “better identify trends in cohorts’ defaults after the two-year cohort period has ended.”\textsuperscript{30} Since the date of that report, both student borrowing and student debt have soared but the public information available on student loan performance has not substantially improved.

\textbf{UNKNOWN INFORMATION}

This report has identified numerous gaps in available data on for-profit colleges. Current publicly available information is limited to data reported to the U. S. Department of Education and, for the fourteen publicly traded schools, quarterly and annual financial filings made to the Securities and Exchange Commission. As noted, what data is collected by the U. S. Department of Education has several serious limitations.

First, the U. S. Department of Education only tracks completion rates for first-time, full-time enrolled students, a metric that is not well-suited to the for-profit model where many students enter school with previous college credit or attend part time. As a result, these outcomes measures fail to capture many for-profit students and make it difficult to understand how many students are completing programs, transferring or dropping out.

Second, job placement information is reported inconsistently and not subject to uniform standards. This data is self-reported and there is no audit or verification procedure outside the confidential periodic accreditation review to ensure accuracy or public access to that information.

Third, many schools do not consistently publish tuition information, making it difficult for policymakers or consumers to compare schools and track tuition increases.

Fourth, default rates that help to elucidate how students leaving for-profit schools are faring in the workplace are only tracked for three years, and do not fully capture students who default outside that period. And because default data looks at a student population leaving school several years back, it may not adequately depict the current economic situation of recent graduates and dropouts, nor a significant shift in student borrowing.

Finally, for privately held schools, no information is available about how they spend Title IV dollars. Even for publicly traded schools, annual filings only provide a general understanding of how Title IV


\textsuperscript{30} Department of Education Inspector General. Audit to Determine if Cohort Default Rates Provide Sufficient Information on Defaults in the Title IV Loan Programs. December 2003, page 2.
dollars are divided between education, administration and marketing. As a result it is very difficult to make a comprehensive assessment, particularly of privately held for-profit schools, based on publicly available information.

This list begins to outline some of the significant gaps in data on for-profit colleges. Congress should seek to fill those gaps to allow for an informed discussion and debate over the significant federal investment in for-profit institutions.

**CONCLUSION**

The Federal government and taxpayers are making a large and rapidly growing investment in financial aid to for-profit schools, with few tools in place to gauge how well that money is being spent. Available data show that very few students enroll in for-profit schools without taking on debt, while a staggering number of students are leaving the schools, presumably many without completing a degree or certificate. To boost enrollment, some for-profit schools recruit large numbers of new students each year. In some cases, schools enroll more students over the course of the year than were enrolled at the beginning of the year. To ensure these enrollment increases, it is necessary for the schools to devote very large shares of Title IV dollars and other Federal financial aid to marketing activities, not education.

These schools are increasingly relying on Federal financial aid dollars for revenue. When all Title IV, Department of Defense and Veteran’s Administration funds are included, many of these schools are receiving nearly all of their funds from Federal sources. While increasing their reliance on Federal dollars as a source of revenue, for-profit schools are at best spending only slightly more than half of revenues actually educating students, and in several cases are shrinking the amount spent on instruction. Yet these same schools are reporting profit margins of 20 percent and higher to investors.

Students at for-profit schools are also taking on higher amounts of debt than their peers at public and non-profit schools. Nearly half of student loan borrowers who entered repayment in 2007 and defaulted by 2009 attended for-profit schools (44 percent), even though less than 10 percent of students attend these schools.\(^{31}\)

The publicly available data, in tandem with mounting reports of questionable practices and poor student outcome, yields a mixed portrait of the for-profit higher education sector that calls into question the taxpayers return on their multi-billion-dollar investment, and leaves many unanswered questions with regard to whether a sufficient number of students receive an education that provides them with the knowledge and skills they need to obtain jobs to repay their student debt.

**SCOPE AND METHODOLOGY**

This report is based largely on publicly available information from the U.S. Department of Education and the 10-k filings of the 14 publicly traded companies that operate for-profit schools. It is not meant to suggest that any one company or school is the focus of this report or that similar results would not be found among for-profit schools that are not publicly traded. In order to avoid any suggestion that a particular school is a focus, whenever possible schools have not been identified by name, and the largest schools have been averaged together to provide a more accurate cross-section of the industry. The Chairman will provide further information underlying the charts and statistics in this report upon request.

\(^{31}\) TICAS analysis of U.S. Department of Education three-year Cohort Default Rate data for FY2007