

Current thinking from Haven Financial Advisors

## Your Scholarship is (Probably) a Sham



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### Special Notes of Interest:

Median family wealth in the US is \$81,450. That's 5% lower than it was 25 years ago.

The forward P/E ratio of the S&P 500 is 16.8 as of July 24<sup>th</sup>

Sending a child to college often feels like buying an airline ticket. Everybody is paying a different price. Published tuition rates are merely a starting point from which a game of discounting ensues. Heightened competition for students and massive government subsidies have added significant complexity to the cost of higher education. We explore the problem in this edition of *Intelligent Money*.

### College Pricing Goes High Tech

Tuition at our nation's colleges has been growing at a rate that exceeds baseline inflation for decades. But that's only part of the story. Most matriculating students receive financial aid of some kind. Those receiving the aid aren't who you think they are.

Federal programs like Pell Grants are still need based. However, at the institutional level, factors unrelated to economic hardship determine financial aid offers. Such assistance is often referred to as merit based aid or "scholarship". In the five years ending in 2012, aggregate merit aid at US colleges increased 64%. At many campuses, more than half the students get this kind of financial assistance. More proud parents can boast that Johnny is receiving a scholarship.

The competition for paying students is intense. From a purely economic standpoint, it makes more sense for colleges to offer partial discounts to families that **can** pay most of the freight. Economists call the phenomenon price discrimination.

There is a cottage industry of consultants that assists colleges in pricing optimally to maximize yield. One of the big players in this space is Ruffalo Noel Levitz. The firm ably uses big data to estimate the maximum price that a student's family is willing to pay.

The "sticker" price is set high. Financial aid packages are then tailored for most applicants so that the net cost is about as much as they are willing to pay. Family income, number of children, parent education, zip code—all factor into the firm's predictive tuition price model. Of course,

the aid packages are conveyed privately to minimize information sharing among consumers.

The needy student is the odd man out in the modern world of college revenue management. Most institutions of higher learning now rely on the Federal government to provide funding for matriculating students with limited resources. They have effectively passed the buck to the taxpayer. "We have \$2.4 billion in need that we are not filling, and there's \$3.3 billion we're spending for students who could afford to attend college," says Tori Haring-Smith, president of Washington & Jefferson College in western Pennsylvania.<sup>1</sup>

Researchers from the National Center for Education Statistics studied the 12 year period from 1996 to 2008 and found that the locus of financial aid had shifted clearly to higher income students:

The net effect of these shifts is a change in the distribution of dependent students who received any grant aid toward students from higher income families. The percentage of all grant recipients (merit and need-based) who were in the lowest income group was higher in 1995–96 (41 percent) than in 2007–08 (37 percent) and the percentage who were in the highest income group was lower in 1995–96 (13 percent) than in 2007–08 (18 percent).<sup>2</sup>

The *Hechinger Report* reviewed college costs from 2007 through 2012. They found that the prices (after aid) of college education rose *faster* for lower income students than for higher income cohorts.<sup>3</sup>

There are supplements to the big data approach. Many colleges hire commission based agents to recruit foreign students. These folks pay the full sticker price with the agent keeping about 15% of the first year's tuition. Notably, the use of agents to recruit American students has been banned under federal law for about 25 years.

### How Did We Get Here

Powerful long term forces have been at work in the financing of higher education. The most fundamental of them has been the shift in financial commitment from the individual states to the federal government. State investment in higher education has been in



retreat since 1980. Until that point, state and local governments subsidized roughly three quarters of the cost of their public university systems ... with direct payments to the system. As state budgets have become more constrained, this commitment has been scaled back dramatically. In constant dollars, the amount spent on public higher education has fallen 40% since 1980!

The trend is accelerating. From 2008 through 2013 alone, state spending per student fell 28%.<sup>4</sup> Tuition increases have been closely correlated with the drop in state support.

Into this funding breach has stepped Uncle Sam. Federal aid to higher education has exploded. The average full time student enrolled in the 2013-14 school year received almost \$11,000 in assistance. That represents an increase of 150% in twenty years, *after adjusting for inflation*. Federal aid to education primarily consists of assistance to its buyers - the students - rather than the institutions directly. Its most common forms are grants, student loan guarantees, and tax breaks.

The federal government took other key steps from a policy perspective. The Higher Education Reauthorization Act of 1992 extended the student loan program to America's middle class. Middle income students who did not satisfy the need requirements of the subsidized Stafford program had access to another federally guaranteed student loan program.

Until the 1990s, a group of selective private colleges (including the Ivy League) agreed

on consistent financial aid packages for students accepted into multiple member institutions. The intent of this collusion was to insure that applicants selected a school based on what it offered rather than its price. Sounded noble enough but it ran afoul of federal antitrust laws. Under pressure from the US justice department, the colleges agreed to drop their collective financial aid packaging. In fact, the justice department continues to monitor any attempts among colleges to coordinate financial aid.

America's higher education system faced a perfect storm.

- Decreased subsidy from its traditional funding source: the states.
- A massive influx of federal dollars to students and families in the form of grants, loans, and tax breaks
- A competitive financial aid environment

It's small wonder that educational institutions started engaging in creative schemes to extract tuition from their students. They became more dependent on tuition just as Uncle Sam was fronting a lot of that money.

The irony is that the new status quo has put college education further out of the reach of America's poor. For those with the financial capacity, though, the takeaway is simple: Play the same game as the colleges do. Negotiate. If your child has multiple aid offers, there is no reason why you can't go back to the colleges and ask for more. According to published data, the average "discount" at private colleges was 45%. Colleges often have wiggle room relative to their first financial aid offer. Go after it.

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## Suggestions for Further Reading

Lucie Lopovsky, *Forbes*, July 30<sup>th</sup>, 2014, What's Your Tuition Discount?

Maggie McGrath, *Forbes*, July 30<sup>th</sup>, 2014, The Invisible Force Behind College Admissions

Stephen Burd, *Washington Monthly*, September/October 2013, Merit Aid Madness

Lynn O'Shaughnessy, *CBS Moneywatch*, What College Aid Officers Won't Tell You, March 5, 2009 & April 24<sup>th</sup> 2009.

Jenny Woo & Susan Choy: *National Center for Education Statistics*, Merit Aid for Undergraduates: 1995-96 to 2007-08,

Jon Marcus and Holly Hacker, *The Hechinger Report*, Poorer Families are Bearing the Brunt of College Price Hikes, March 9<sup>th</sup>, 2014

Phil Oliff et. al. *Center on Budget and Policy Studies*, Recent Deep State Higher Education Cuts May Harm Students and the Economy for Years to Come, March 19<sup>th</sup>, 2013.

Kevin Carey, *Chronicle of Higher Education*, Fixing Financial Aid, March 4<sup>th</sup>, 2013