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Students Get Tuition Aid for a Piece of Their Future

Income share agreements seem poised to take off, as costs and debt loads rise

The average funding amount from Purdue University's Back a Boiler income share agreement is just over $13,000. PHOTO: PURDUE UNIVERSITY

By Jillian Berman

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To help pay for ever-growing college costs, more students may soon be trying a new approach: selling rights to their future earnings.

Long discussed in college policy and financing circles, income share agreements, or ISAs, are poised to become more mainstream. A handful of backers currently exist that in effect have invested in college students' futures by advancing them thousands of dollars in tuition money to bridge gaps in financing when student loans don't quite meet all of their expenses.

Under the terms of a typical ISA, students agree to pay a percentage of their future earnings for a predetermined period in exchange for help up front with their tuition. Now, more students may have the opportunity to enter such deals, as lawmakers in Congress are working on possible ground rules for the agreements.

Gaining support

A flagship public university has its own ISA program with more than 160 participants last academic year, and several other colleges have launched or are considering starting ISA initiatives of their own. Meanwhile, at least one company, founded in 2015, exists solely to facilitate the agreements for educational providers.

"What I see now is a lot of different institutions giving it a try," says Miguel Palacios, assistant professor of finance at University of Calgary's Haskayne School of Business and co-founder of Lumni, an organization offering students in Latin America ISAs since 2002 and in the U.S. since 2009.

While so far there are only a few providers of ISAs in the U.S.,

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discussions about broadening the practice are picking up steam. The basic incentive for investors is that the student, under the terms of the agreement, could end up paying back more than the amount that was advanced—similar to a student loan—thus earning the investor a profit. Companies could see ISAs as a way to attract future employees, by pledging to help pay their tuition in return for future years of service—and repayment. The deals also allow colleges to create another avenue of financing for students as families become increasingly wary of taking on traditional student loans.

As a safeguard, some agreements require the student to repay the investor only if his or her salary is above a certain amount.

Closing gaps

Right now, because it's hard for the agreements to undercut the generous terms of federal student loans, ISAs are only being discussed seriously for students who still owe tuition after hitting the limit for federal student loans. ISAs are thus viewed as competing mainly with private providers of student loans.

Some advocates try to argue ISAs are not loans, says Mark Kantrowitz, publisher of Cappex.com, a college and scholarship search site. “An ISA is still a loan,” Mr. Kantrowitz says. “Investors are interested in getting the same amount of profit from an ISA as they would from a loan.”

Mr. Kantrowitz calculates that students who borrow $37,000 through an ISA and earn $50,000 a year would likely wind up paying back between $55,528 and $88,845 under a typical ISA, assuming they pay back the money over 10 years. Many ISAs are structured so that students pay them back in less than 10 years. Still, if those agreements were a 10-year loan, they’d have an interest rate of between 8.7% and 21%, Mr. Kantrowitz found.

Depending on how an agreement is structured, the repayment obligation could be usurious, Mr. Kantrowitz says.

Indiana’s Purdue University introduced its Back a Boiler program last year to much fanfare. The administration decided to create its own program without waiting for regulatory clarity, says David Cooper, chief investment officer at the Purdue Research Foundation, which is in charge of the ISA program at Purdue. The foundation has been in touch with the lawmakers in Congress interested in regulating ISAs to make sure Purdue is following proposed guidelines, Mr. Cooper adds.

Mitch Daniels, the university’s president and a former Republican governor of Indiana, has said he wants Purdue to become a “national test bed” for ISAs.

ISAs at Purdue are available to rising sophomores, juniors and seniors for a maximum of 15% of their anticipated salary after graduation. The school only recommends ISAs as an alternative for private loans or government loans made to parents, not federal student loans. The 161 students participating last academic year secured financing of $2.1 million through the program, Mr. Cooper says. The average funding amount is just over $13,000, Purdue says.

Students whom Purdue expects to have relatively lower-paying jobs after graduating will pay a larger percentage of their income over a longer period than those expected to earn relatively high salaries. For example, a typical junior English major would agree to pay 4.97% of his or her income for 116 months, while a typical junior chemical engineer would pay back 2.81% of his or her income for 88 months. The students could wind up paying close to the same amount, however, depending on their salaries.

If Purdue students in the program want to prepay their obligation, they will pay back 2.5 times the initial funding amount. Students don't begin the payment period until six months after they graduate, or withdraw or fall below half-time enrollment at the university. They could wind up paying nothing if they are employed and earn less than $20,000 a year, or if they are unemployed and can prove to the school they are actively looking for work. For students who attend graduate school full time, the payment obligation is deferred while they're in school at no additional cost.

Zachary Meyer, who just started his last year at Purdue, got an ISA after consulting with his dad. He says he liked the idea because he knows he won't need to pay back the money in the event he has a low income.

Purdue student Zachary Meyer says he'll be paying back the $10,000 he borrowed over 104 months at a rate of 3.679% of his income. PHOTO: VALEO FINANCIAL ADVISORS

"It's kind of cool," he says."It's hopefully going to pave the way for this being a really popular thing and a better way for people to finance their education."

Mr. Meyer concedes he may feel differently about how "cool" the deal is once he's out of school and the money is coming out of his paycheck. He'll be paying back the $10,000 he borrowed over 104 months at a rate of 3.679% of his income.

Assisting Purdue with the running of the program is Vemo Education, a company set up to provide universities and other education providers, like bootcamps, in the U.S. with technology to run their own ISA programs. Launched in 2015, Oakton, Va.-based Vemo says it facilitated $23 million worth of ISAs in the 2016-2017 academic year, and expects that to grow this year.

Relatively unregulated

One obstacle to the products becoming more mainstream, however, is that they remain relatively unregulated. A bill introduced earlier this year by Rep. Luke Messer (R., Ind.), and which has bipartisan support, would provide protections to students and investors. The proposed bill specifies the terms that must be included in the contract, such as a definition of income and repayment period, for the deal to be legal. The legislation caps funding at 15% of future income for ISAs with terms of 15 years or less, and 7.5% for the longest deals the bill allows—up to 30 years. Investors can't require borrowers earning 150% of the federal poverty line for a single person or less to pay an ISA.

James Fish, chief financial officer at Clarkson University, a private nonprofit college in Potsdam, N.Y., says regulatory clarity would be helpful as the school works to develop its own ISA program. Clarkson is still in the early stages of researching how best to structure the contracts, he says.

Clarkson officials decided to pursue an ISA financing option after a trustee offered to fund a program at the school. They plan to have it up and running by fall of 2018, according to Mr. Fish.

Some critics of ISAs worry about the idea gaining momentum. David Bergeron, a senior fellow at the Center for American Progress, says lawmakers should focus on containing the cost of college instead of developing alternative financing mechanisms. He suggests solutions like increasing investment in public universities and pressuring schools to be smarter about their spending, for example, through shared faculty health plans for institutions in proximity.

Institutions offering ISAs right now are being extremely cautious, he says. But, once a law is passed, he warns, more groups will go right up to, or over, the regulatory line.

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The federal legislation being considered includes a provision saying state usury laws wouldn't apply to ISAs, since the agreements technically don't charge interest. Still, states could set their own rules that apply specifically to ISAs to protect students from usurious-like behavior.

Jason Tyszko, executive director of the U.S. Chamber of Commerce

Foundation Center for Education and Workforce, says his group has had exploratory conversations about using ISAs as a way to pay for employee training. Mr. Tyszko says he doesn't know of any employers who have used ISAs yet, but he thinks many could be awaiting regulatory clarity.

Mr. Kantrowitz says he thinks some employers will shy away from ISAs because there are people who view them as indentured servitude. Many companies already offer tuition benefits to their workers that require them to stay on for a certain period after the degree if they want to avoid paying it back, he adds, which means ISAs don't offer a hugely different guarantee.

It's important to get specifics before signing on to an ISA, says Mr. Kantrowitz. Students should estimate the monthly payments they will owe and the amount they'll pay over the lifetime of the agreement to ensure it isn't costing them more than a traditional loan. They also should see if there might be any tax consequences if the balance is written off after the end of the repayment period.

Mr. Bergeron recommends students ask questions like: How might an ISA interact with the borrower's student loans? Is the income from which the payment is calculated after federal student loan payments or before? What happens if the borrower becomes disabled? Will the investor include Social Security or other disability benefits in the income calculation?

Despite the risks and unanswered questions, Mr. Kantrowitz says that for some students, particularly if they are especially debt averse, an ISA could be a preferable option to taking on a private loan or asking their parents to borrow on their behalf.

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