COLLEGE SAVINGS INITIATIVE

The Basics of Progressive 529s

The College Savings Initiative

The College Savings Initiative was launched in 2009 as a joint venture of the Asset Building and Education Policy Programs of the New America Foundation and the Center for Social Development (CSD) at Washington University in St. Louis. The Initiative is centered on developing and advancing progressive 529 college savings plans at the state and federal levels. It seeks to achieve this through study and promotion of existing progressive state-based 529 plans; modernization of existing federal college aid programs, including federal income tax-based aid programs; policy research and design; communications; and policymaker education. Ultimately, the Initiative aims to increase post-secondary education access and completion rates among lower-income, disadvantaged students through innovative public policy and other reforms to 529 college savings plans.

Background on 529 college savings plans

In 2001, the Internal Revenue Code authorized college savings plans (529 plans) as a tax-advantaged savings tool. In a 529 plan,[1] individuals save money in an account that is dedicated for future college expenses of a beneficiary. States administer 529 plans, and offer a limited selection of funds with a range of risk and return characteristics.[2] In addition, contributions are tax deductible in many states for state-resident contributions to 529 plans. The account owner chooses a beneficiary, who can be changed at the owner's discretion.

The account may be used at any eligible educational institution, including public and private colleges and universities, graduate and post-graduate schools, community colleges, and certain proprietary and vocational schools.

Although there is growth in awareness and participation, people saving in 529 plans have higher incomes and assets than those not saving in these plans. In addition, 529 plans are regressive in their current form. Tax incentives provide more benefit to people with higher incomes. Individuals with lower incomes have little or no tax liability and may have little wealth to transfer into 529s to take advantage of tax-free earnings. By 2003, an estimated 8% of United States households had opened one or more 529 savings plan accounts. Among households that did not own a 529 savings plan, 61% were aware of 529s. Among households with annual income under $50,000 and without a 529 savings plan, almost half were aware of 529s (Investment Company Institute, 2003).

Although current participation in 529 plans is primarily among mid-to-high-income families, the 529 savings platform lends itself to a more inclusive saving policy. It is the characteristics of 529s—especially public oversight, centralized accounting, low deposit minimums, and matching provisions—that can become building blocks for more inclusive policy.

[1] There are two types of 529 plans: college savings plans and pre-paid plans. This proposal focuses on 529 college savings plans.

[2] Typically administered by state Treasury Departments, 49 states and the District of Columbia now have 529 savings plans in operation.

The Case for Progressive 529s

As a substantive matter, America is falling behind other nations in college attainment growth rates, particularly at the associate degree level—at precisely the time the economy is increasingly demanding heightened innovation and skilled workers. Although post-secondary access is widespread, high achieving low-income students still are underrepresented in higher education. For median-income families, post-secondary education is increasingly unaffordable and prompting dangerously high levels of student loan debt, particularly private student loan debt. Finally as a substantive matter, there is a college dropout crisis among low-income and minority youth. If America's college attainment rate is to increase appreciably, disadvantaged students need both greater financial support *and* improved academic preparation.

Students and prospective students are also increasingly being asked by parents, colleges and states to generate more of their own savings and resources to start and complete college. 529s are emerging as a primary public policy for encouraging families to save for college, but these systems—notwithstanding modest progressive 529 reforms in several states—are, as already discussed, highly regressive and of little benefit to precisely those households most in need of public support. It is therefore imperative to ensure that as 529 plans continue to grow, they do so in ways that include low-income youth, young adults, and their families.

The political and legislative agenda suggests that now is an excellent time for this work to begin. The scheduled 2010 and 2011 expiration of various higher-education related tax benefits, in addition to the Bush 2001 tax cuts, mean federal tax policy will be reconsidered and revised in 2009 and in all likelihood 2010 as well.[3] Also, expiration of the Ensuring Continued Access to Student Loans Act in July 2010 and ongoing credit market troubles suggest Title IV student loan reform will be on the legislative agenda in 2009 as well.[4] Following tax and student loan reforms, beginning in 2011, higher education interest groups will begin their internal process of developing proposals for the next reauthorization of the Higher Education Act.

Expanding 529s can be a true "win-win": More low-income students would be able to afford and be oriented toward higher education; policymakers can better reach their goal of educating more needy students; post-secondary education providers potentially earn more revenues by educating a greater number of students; and the private sector can earn more revenues through higher numbers of accounts and assets under management. Such broad appeal holds the potential for inclusive 529s to be both enacted in the shorter term as well as sustained over the longer-term.

529s as a vehicle to promote college access, readiness, and completion

The inclusive 529 concept presents an exciting and relatively new means to address protracted issues in post-secondary education and high school policy areas. Issues of college access, readiness, and completion are intensely related, but normally addressed in long-standing, separate education policy silos. For example, post-secondary education student financial aid largely fails to leverage high school course selection even though high school curricular rigor is the number one indicator of college completion.[5]

Unfortunately and for years, high school age students and their families have wildly overestimated gross post-secondary education costs and underestimated available financial aid, impacting college access. Secondary school student course selection and performance regularly leaves students underprepared for college level work. Accordingly, application rates to post-secondary education are artificially depressed

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[3] Further, Democratic Party Presidential nominee Senator Barack Obama has proposed a $4,000 refundable tax credit for higher education costs. Democrats and Republicans in Congress, including Members of the House Ways & Means Committee, have proposed making the HOPE and Lifetime Learning tax credits refundable beginning in 2010.

[4] Senator Obama has proposed an overhaul in the federal student loan programs. Undersecretary Sara Martinez Tucker is scheduled to do the same in the Fall of 2008.

[5] See Adelman, 1999)

and college completion rates dismal. According to an American Council of Education survey, the average family estimates college is three times more expensive than it actually is.[6] They are unaware of the extent of federal financial aid, including aid provided through the tax code. According to the Advisory Committee on Student Financial Assistance, some 200,000 college qualified students fail to enroll in a post-secondary training each year due to cost.[7] To date, there has been little research on the impact that overestimates of net college price has on secondary school course selection, performance, and college enrollment.[8] But "Conditional Cash Transfer" pilot programs for secondary school students begun in the New York City, Washington, DC, and Baltimore school systems offer a potentially rich data source to test the relationship between early, tangible, and guaranteed financial assistance and academic preparation activities in high school.[9]

It has been established clearly, however, that low-income and minority secondary school age youth are "less likely to take courses required for acceptance and enrollment in selective colleges, [and] less likely to perform well in high school."[10] Indeed nearly two out of five students who enroll in post-secondary education programs are required to take a remedial course in college.[11] The college dropout rate for those students is in excess of the 50 percent norm.[12]

A group of prominent higher education academics, under the auspices of the College Board, recently proposed development of an account-based, federally funded savings program for students from low-income families analogous to the 529 college savings program utilized by upper-income families.[13] Sponsored by the Spencer and Lumina Foundations, the College Board group called for the creation of tax-preferred accounts for young children, capitalized with early Pell Grant funds, in order to heighten college aspirations, access, and success. They argue a tangible commitment of early financial aid has the potential to alter the way families of secondary school age students view academic preparation in high school. With their own personal college fund—for which they get regular statements—it is argued that low-income students will be more likely to take, and take seriously, necessary courses in high school knowing that they have money saved for college. They will be more likely to begin the college application process and in turn be funneled into the financial aid application process as well. The combination of better academic preparation in high school and Title IV financial aid application will make them more likely to complete a post-secondary degree.

The College Board group envisions an account-based Title IV student aid program operating side-by-side with existing 529 plans. One possibility is that the two programs could be combined along with existing and potentially expanded federal higher education tax benefits. Such an effort requires significant Title IV education and tax policy design research, but if successful, it could exponentially increase the amount of guaranteed early financial aid for post-secondary education and associated college readiness activities, access, and completion rates.

529s and Federal Higher Education Tax Credits

Unfortunately, current federal higher education tax benefits, including the HOPE Scholarship and Lifetime Learning Credits, by design are ill-targeted, ill-timed, unrestricted to education costs, and almost universally unavailable to the more than 40 percent of post-secondary education students attending community colleges. The credits operate as middle class tax relief programs, but at best have minimal impact on post-secondary education access.

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[6] See American Council on Education, 1998; see Horn, Chen, & Chapman, 2003

[7] See Advisory Committee on Student Financial Assistance, 2002

[8] See Mundel, 2008) See Mundel, *What do we Know About the Impact of Grants on College Students* in *Rethinking Student Aid*, College Board, Sept. 2008.

[9] Expansion of these models could operate in conjunction with inclusive or progressive 529 accounts.

[10] See Mundel, 2008

[11] Reference coming

[12] Reference coming

[13] Baum, McPherson, et al. *Fulfilling the Commitment: Recommendations for Reforming Federal Student Aid,* 2008.

More than one in five high-school age students cannot expect to receive help from either of the two main non-refundable federal higher education tax credits because of insufficient family income, according to the Center on Budget and Policy Priorities. One in four middle class families eligible to receive a credit claims less than the maximum to which they are entitled, according to the Government Accountability Office. Half of their tax returns are prepared by commercial services. Claimed funds are delivered as much as a year and a half after tuition bills are due. And because the credits only offset tuition and fees, which are relatively low at community colleges, rather than total cost of attendance, hardly any family attending a two-year public college receives a HOPE Scholarship or Lifetime Learning credit, according to the Institute for Higher Education Policy.

To respond to these shortcomings, pending in Congress and offered by President Obama are various proposals to expand, consolidate, and make refundable the higher education tax credits. These are all worthy proposals whose effectiveness, like the current credits themselves, would be enhanced if coupled, in whole or in part, with the 529 platform. In addition to the other benefits associated with the account-delivered benefits described elsewhere herein, inclusive 529 college savings plans capitalized with Title IV aid *and* refundable, expanded, and advanced federal higher education tax credit funds have the potential to address more fully each of the current shortcomings associated with the HOPE and Lifetime Learning Credits. If made refundable and expanded, an increased number of low-income families without taxable income would benefit from the credits. Because low-income households don't have to file a tax return to access 529 funds, take up rates should be higher. Withdrawals from 529 accounts are simple. Funds are available immediately upon enrollment and in uncapped annual amounts. And because 529 funds can be used for total post-secondary education expenses, not just tuition and fees, they are of value to community college as well as traditional four-year institution students.

<u>State Innovations</u>

In a survey of state 529 plan administrators, CSD has found that many states have reached out to lower-income populations. Strategies include: matching deposits in 529 savings accounts, connecting 529s with federally-funded GEAR UP (Gaining Early Awareness and Readiness for Undergraduate Programs), excluding 529 savings from state tuition grants calculations, and enrolling participants in the workplace (Clancy & Sherraden, 2003). Some states create partnerships with public and non-profit organizations to help families learn about 529s and saving for college in venues such as school systems, public libraries, and child care centers, or via the State Department of Human Resources (e.g., mailing 529 savings plan information with every birth certificate) (Ferguson, 2004). Eleven states (listed in the Appendix) currently offer 529 savings matches for account owners or beneficiaries who are state residents (Clancy, Mason & Lo, 2008). State match designs vary in terms of funding, eligibility, and application.[14] 529s can also leverage contributions from a wide range of family, private, non-profit and public sources, as well as provide a platform for financial literacy, lifelong learning, and skills upgrading (there are no age restrictions on 529s).

There is potential for 529 plans to reach a broader population. Some states have developed features in their 529 plans that facilitate the participation and saving of low-to-middle income families. How do these features affect participation rates? Do the features help account owners save? Answers to these questions can inform program and policy development. To date, there has been little research on inclusive aspects of 529s. Policy innovation in the states is often the precursor for large-scale federal policy. In aiming for a universal savings policy, policy development in the states can be a key strategy. Innovations for inclusion in 529 plans are widespread and they are a rich resource for the nation (Clancy and Sherraden, 2003; Clancy, Cramer, and Parrish, 2005).

[14] Michigan offers a match on deposits only within the first year of opening the account. Others, such as Louisiana and Minnesota, offer annual matches. In some cases, the match increases as household adjusted gross income decreases.

Summary of Existing States with Matching Grant Programs
As of October 2008

Arkansas	2:1 Match for families with Adjusted Gross Income (AGI) below $30,000; 1:1 match for families with income between $30,000-$60,000 up to $500
Colorado	1:1 Match for low-to mid income families, up to $500 annually
Kansas	Limited pilot: 1:1 match for contributions above $100 up to $600 for families below 200% Federal Poverty Line
Louisiana	2% to 14% Match on deposits to accounts based on the Federal Adjusted Gross Income of the Account Owner and the Category of Account.
Maine	$50 initial grant and .5:1 match up to $200 annually for families with AGI below $54,500. Parents of state-resident newborns may submit application for $500 grant.
Michigan	One time 1:3 matching grant, up to $200, for families with AGI below $80,000
Minnesota	Up to $400 per year matching grant for low and middle income residents
North Dakota	One time, 1:1 match up to $300 for families earning below $20,000 (single) or $40,000 (joint)
Rhode Island	2:1 Match for families with AGI below $65,000, up to $500; 1:1 match for families with AGI below $80,000, up to $500
Texas	Matches available for families with annual household income below the state median.
Utah	Pilot program to match contributions 1:1 up to $300 per year