Early Commitment of Financial Aid

Individual Development Accounts (IDAs) for Higher Education

A College Readiness Issue Brief from the Pathways to College Network
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The Problem: Producing enough college graduates for future needs

The education pipeline in the United States will not produce enough college graduates to stay competitive in the global economy unless current trends are reversed (Callan, Ewell, Finney, & Jones, 2007). The fastest-growing populations – generally low-income and often from racial or ethnic minority groups – do not have the aspirations, academic preparation, or means to successfully pursue higher education. They leave high school, enroll in college, and complete postsecondary credentials at substantially lower rates than upper income and White students. Such trends illustrate the urgent need for policymakers to examine education policies aimed at improving college access and success.

Various policies at the federal and state levels foster increased college-going among under-represented groups. They include need-based financial aid, college access programs such as TRIO and GEAR UP, and early financial aid commitment programs such as Indiana's 21st Century Scholars and the Wisconsin Covenant programs. Yet, existing policies alone are not sufficient to reverse the downward trends in the education pipeline. New, innovative strategies need to be developed and scaled.

This brief examines a relatively new initiative - Individual Development Accounts (IDAs) - that could be added to current policies and bundled in existing programs to assist low-income populations with managing college costs.

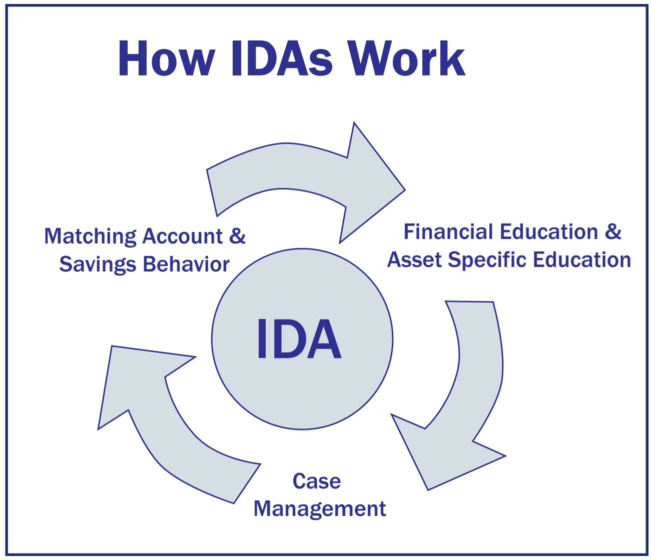
What are IDAs?

IDAs are matched savings accounts designed to encourage low-income individuals to save towards and acquire an appreciating asset, such as homeownership, entrepreneurship, or postsecondary education. Funds saved by the individual are matched by state, federal, and/or private dollars. Most IDAs are coupled with financial literacy education, training to acquire the asset, and case management to assist people with realizing their savings goals. Therefore, IDAs offer the promise of not just matched funds, but the opportunity to foster important life skills and behaviors related to financial management, credit, and debt – skills crucial to financial independence. They help people develop lifetime habits of goal-setting, saving, financial planning, and asset building that can break the cycle of poverty.

Over the years, research has shown that lack of assets, as well as income, keeps the poor in a cycle of poverty and that low-income families can save and build assets if provided with institutional supports parallel to incentives available to middle and upper income families (i.e., 401Ks) along with financial education, support, and goal-setting planning tools.[1]

Policymakers recognized IDAs in the 1990s when Congress passed the Assets for Independence Act (AFI) of 1998, which provided funding to support the creation of IDAs. Today hundreds of organizations offer IDAs throughout the country. A directory of federally funded IDA programs in each state is available at http://idanetwork.cfed.org.[2]

This is how AFI-funded education IDAs work. Qualified low-income (200 percent of the federal poverty level) individuals open IDA accounts with a participating organization and start saving monthly.[3] Most often they are required to take financial education training before enrolling. Participants save a total of $1,000 to $2,000 over two to three years, which is matched by the organization with as much as $4,000 to $8,000 (a match rate of 1:1, 2:1, or even as high as 8:1). The participants' savings and match are held in escrow by the organization and then paid directly to the education institutions when they enroll. As people save, they receive case management services, which encompass assistance with budgeting advice on paying for college and financial education. AFI-funded IDAs can be used to cover tuition, fees, books, and computers. AFI IDAs have specific time limits – participants have up to four years to save and spend the money.[4]



Why are IDAs important?

IDAs can help expand college access and success for individuals from low-income backgrounds in several ways:

Increasing college aspirations
There is evidence from a recent study that low-income families – both parents and children – who save even a small amount (as little as $100) for college in an IDA are more likely to want to go to college than similar low-income individuals who don't (Elliott & Wagner, 2007; Elliott, Sherraden, Johnson, Johnson, & Peterson, 2007). Other research has found a similar connection between parents' savings for college and children's college aspirations (Hossler, Schmidt, & Vesper, 1999).

Reducing anxiety about paying for college
IDAs operate similarly to other early financial aid commitment tools in which the state makes a commitment of aid to students in middle or early high school grades, providing they meet certain academic and other requirements. Examples include Indiana's 21st Century Scholarship Program and Oklahoma's Promise Scholarship. Making an early commitment of funds (the individual's and the matching agency's) for college costs mitigates concerns that students have about whether they will be able to afford college and provides an incentive for them to prepare and plan for college.

Reducing debt burden
Students finishing bachelor's degrees owe an average of $19,200, an amount that has more than doubled over the past decade (Project on Student Debt, 2007). Credit cards add to graduates' debt with 41 percent of college students who have credit cards carrying a balance of $1,000 from one month to the next. IDAs can provide students with additional money, which will allow them to have less debt.

Increasing college persistence
Many low-income students leave college before completing degrees because of financial stress related to the cost of attending, such as books (the cost of which has increased 600 per cent in the last decade), childcare, and transportation. The financial literacy training provided by IDA programs on topics such as credit, debt, and the total cost of attending

college can help students better manage the resources they have to pay college costs, persist, and graduate.

IDA Facts

- In a five-year evaluation study, IDA participants were 21 percent more likely to pursue postsecondary education than similar non-participants (AFI, 2008).
- Currently, there are 65,000 IDA participants. 5,800 (19 percent) have used their savings for education (AFI, ORR, CFED, 2007 Survey).
- 76 percent of AFI IDA participants are female, 44 percent are African American, 27 percent are Caucasian, and 18 percent are Hispanic (Report to Congress, 2008).
- AFI projects are located in 49 states and the District of Columbia. Wyoming does not have an AFI project.

IDAs in Action

The experiences of institutions and states that offer education IDAs demonstrate their potential for increasing college-going among low-income students.

Central New Mexico Community College (CNMCC) offers IDAs in partnership with a local community action agency (CAA). The CAA applies for and manages the federal IDA grant, tracks participants, and meets government reporting requirements, while the CNMCC foundation matches the federal funds.[5] The college's Center for Working Families recruits students, offers financial education, and provides case management services in partnership with other college departments such as advising, financial aid, and the job resource center. Students save for two years in the program with every dollar they save matched by $3.00. Students participating in the program have a 92 percent retention rate compared with a 50 percent retention rate for similar students who were not saving in IDAs.

Oregon offers a state-funded IDA, known as the Neighborhood Partnership Fund (NPF), which markets and sells tax credits on behalf of seven fiduciary organizations in the state in order to generate state funds ($6 million in 2008) to support education IDAs. Non-profit entities administer the IDA program, including fund-raising, managing the bank relationships, maintaining the IDA custodial accounts, and tracking IDA savings. Community and Shelter Assistance (CASA) of Oregon is partnering with two community colleges and a network of private colleges to offer IDAs. The non-profit encourages the college partners to brand, market, and recruit students as IDA savers, and provide financial education and case management services; the non-profit also offers an administrative fee to colleges for every student they enroll in an IDA. The potential to increase college-going among low-income students using this approach is significant.

Potential of IDAs

Many other populations, institutions, and programs have been identified as potential successful target markets for IDAs.

1. IDAs can assist students who currently have few resources available to help them with college costs – for example, students who have defaulted on loans, undocumented students, students taking certain non-degree courses, and those who are excluded from other financial aid programs.
2. Many colleges and universities have institutional scholarship funds they could use as match funds for IDAs, thereby encouraging students who have the capacity to save but otherwise might not do so.
3. IDAs can encourage savings among groups that need additional support because of difficult life circumstances but who typically have not been able to save for education. They have been used successfully with foster care youth, Native Americans, and other high-risk populations.

4. IDAs can be integrated with existing programs such as TRIO and GEAR UP at little or no additional cost. Doing so strengthens the capacity of such programs to encourage saving for college and provides their participants with important financial education.

Challenges of IDAs

In considering the development of IDAs, there are several important issues for policymakers to address.

Potential impact on financial aid eligibility
By federal regulation, savings in an IDA account are excluded when determining aid. Match funds, however, are considered an outside resource by the U.S. Department of Education. There is a small possibility that IDAs could result in some students receiving less financial aid unless some adjustments in the federal regulations are made. While efforts are underway to change the federal regulations and create a broader understanding among financial aid officers about the way the way the IDA asset can be handled, the issue is a challenge.

Non-profit capacity to manage IDA programs
Currently there is a limited non-profit capacity to offer education IDAs. Many non-profits that offer IDAs focus on housing or financial services. Education IDAs would benefit by being offered through education non-profits or educational institutions. Some form of incentive would encourage education non-profit institutions to manage IDA programs.

Cost of IDAs
IDAs cost on average $64 a month per participant in addition to the savings match dollars because of the significant financial education and case management services they offer (Schriener, 2002). This cost will be recovered over the long term by participants having the knowledge and skills to manage their money more skillfully, thereby avoiding debt and reducing their dependence on public assistance.

Other education savings options with potential for lower–income populations

529 College Savings Plans
Most states have 529 and prepaid tuition plans, created to encourage savings for college. These plans do not provide appropriate incentives for lower-income families who earn too little to benefit from earned income tax credits. Using best practices from IDAs, some states are developing modified 529 programs that work for low-income populations. Maine has a program called "Nextgen College Investing Plan" that includes a matched savings account targeted to families with incomes below $50,000. Studies of the program demonstrate that the matched savings component has provided an important incentive for low-income families to enroll. Eleven states currently offer such plans.
See http://gwbweb.wustl.edu/csd/policy/index1.htm.

Compared with traditional IDAs, modified 529s or prepaid savings plans have no time limits, have an easy enrollment process with no requirements such as financial education, and allow contributions outside the nuclear family.

Some states are developing modified 529 programs that encourage low-income populations to save for postsecondary education.

Roth IRAs
Several national organizations, including the New America Foundation and the Center for Social Development, have been advocating for the creation of Children Trust Accounts for children from low-income families. This proposal is a modified Roth IRA modeled on the United Kingdom's Child Trust Fund where the government establishes an education savings account for every child born. The advantage of a Roth IRA is that it can be used for any kind of asset (not just education) and is therefore responsive to the changing needs of a low-income family.[7]

State Tax Credits
States can offer IDA tax credits as Oregon does through its Neighborhood Partnership Fund. Since 2003, 10 states have offered tax credits. These programs have encountered challenges ranging from insufficient funding to marketing problems and excessive competition (Gunn, Jacob, & Lewis, 2003). Strategies such as better targeted marketing plans, improving staff knowledge of fund-raising and tax credit logistics, and creating collaborations with larger organizations could make these programs more viable.

State-Mandated Financial Education Initiatives
Recently, some states - including Utah, Oklahoma, Nebraska – have introduced legislation that mandates financial education in K-12 schools that address the issue of improving financial education at a broad level. Matched-savings could be incorporated into such state-mandated financial education efforts.

Reaching generationally poor students
Independent students from middle and upper-income families who have dependents may have limited income during their college years, but this is only a temporary situation compared to students from low-income families. While legislatures may decide that they want to fund *situationally* poor students, IDAs were originally conceived to assist *generationally* poor individuals. This challenge can be overcome by targeting institutions that have a high percentage of low-income students for IDA programs.

Recommendations and questions for policymakers

Recommendations

1. States might consider changing their college savings policies to allow IDAs to be rolled into 529 accounts.
2. States might follow examples such as Oregon, Maine, and Texas by modifying 529 accounts and prepaid tuition to provide incentives and vehicles for low-income families to save.
3. Federal and state policymakers might consider developing Children's Trust Accounts, similar to those recommended by the New America Foundation and operating in the UK.
4. States policymakers might encourage financial education as an important K-12 priority and include IDAs or other matched savings accounts as part of this curricular effort.
5. In developing new policy initiatives, national and state leaders might include members of the IDA community who have experience working with low-income populations.

Questions

1. What incentives can be provided for programs that support low-income students (i.e., TRIO, GEAR UP, state funded college access programs) to offer IDAs?
2. What policy changes will be needed in order to exclude IDAs from being counted as a resource in the financial aid need determination process?
3. What criteria can be put into place to ensure that education IDAs are for generationally poor rather than situationally poor students?
4. How can support and incentives be provided for education non-profits and postsecondary institutions to offer IDAs on their own or to partner with community agencies to offer IDAs?
5. Which populations in a state need additional support in order to be encouraged to go to college and are most disadvantaged – Native Americans, Hispanics, rural youth, urban adults?

The information presented in this brief is based on a national research study of education IDAs directed by Dr. Adrianna Kezar, Associate Professor of Higher Education at the University of Southern California's (USC) Center for Higher Education Policy Analysis. For more detailed information on IDAs, visit the website for the research project IDA-PAYS: www.usc.edu/dept/chepa/accounts/). The research study was funded by Lumina Foundation for Education. The author thanks Ann Coles and Cheryl Blanco at TERI and the Pathways to College Network for their assistance with the brief.

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Endnotes

1. Many people are skeptical about whether low-income individuals can save. But there is research that demonstrates that given the right incentives, low-income people can save. To review research on IDAs, see the American dream demonstration reports: Saving performance in the American dream demonstration (2002) and Evaluation of the American dream demonstration (2004). Also, there is a variety of research available from the Center for Social Development, New America Foundation, and Assets for Independence Act websites.
2. However, there are state and private IDAs which are not tracked in any database.
3. Any 501.c.3 organization can apply to offer an AFI IDA. A postsecondary institution's foundation could apply and offer AFI IDAs, but currently we know of few if any colleges that have undergone this process so we refer to community agencies here.
4. While many IDAs are federally funded, others are also privately funded; they would not follow these same restrictions and guidelines and can be individually developed based on the organization's goals.
5. The federal grants program is called AFI -- Assets for Independence. Details about the program can be found at: www.acf.hhs.gov/programs/ocs/afi/.
6. For an overview of several 529 plans and the ways that they might be paired with IDAs, see Clancey, 2003, College saving plans and individual development accounts: Potential for partnership. (details Rhode Island, Maine, Michigan, Minnesota, Louisiana, Oregon, and Pennsylvania). Also, see Clancey & Sherraden (2003), The potential for inclusion in 529 savings plans: report on a survey of states.
7. Clancey, Orzag, & Sherraden, (2004). College savings plans: a platform for inclusive savings policy describes the pros and cons of 529 vs. ROTH IRAs in more detail.

The Pathways to College Network, a national alliance directed by TERI, advances college opportunity for underserved students by raising public awareness, supporting innovative research, and promoting evidence-based policies and practices across the K-12 and postsecondary sectors.

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