Mortgaging Human Capital: Federally-Funded Subprime Higher Education

By Jean Braucher*

I. Introduction

For-profit colleges have expanded rapidly in the last decade, using primarily federal student grant and loan funds for their revenue.¹ These schools, also known as career or proprietary colleges, produce higher debt burdens and default rates for former students compared to other sectors of higher education, indicating many of them do not achieve their mission of preparing students for “gainful employment” that allows them to repay their loans.² It is thus appropriate to classify for-profit higher education as involving fringe credit for the students. Even though much of the credit is in the form of federal student loans with reasonable interest rates, the label “subprime higher education” accurately captures the high risk to individual students from taking out large loans that many will not be able to repay.³ Some students in addition take out private loans to go to for-profit colleges, further upping the risk of default. Furthermore, the demographic profiles of those obtaining this credit—disproportionately poor, minority, single parents, and military personnel—are similar to the targets of other fringe credit providers, such as payday lenders and the purveyors of subprime mortgages involved in the mortgage crisis.⁴ The limited academic preparation of many career college students is another factor making for a high stakes gamble.⁵ Lately there is much discussion of whether higher education in general is

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¹ See infra Part IIA and D.

² See infra Part IIE.

³ See id.

⁴ See Steven Eisman, Subprime Goes to College, Presentation at the Ira Sohn Conference (May 26, 2010) (comparing the bubble in subprime mortgages to the growth in the for-profit college sector). See also U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule (July 26, 2010), Fed. Reg. Vol. 75, No. 142, 43616, at 43654-5 (discussing argument of the for-profit industry that their high default rates are due to enrolling different types of students, particularly low-income students, and rejecting it on the basis that the industry’s own assessment found that differences in student characteristics accounted for only about half of the difference in defaults; also discussing responsibility of institutions to recruit and enroll students who can succeed at their institutions and quoting a blog post of Judge Richard Posner comparing aggressive marketing of for-profit colleges to vulnerable low-income persons lacking in financial sophistication to the marketing of mortgage loans during the housing bubble).

⁵ See infra Part IV.
“worth it.” The answer is more likely to be no for a subprime higher education, as will be detailed below. That other higher education needs reform, too, is not grounds for ignoring the need for targeted regulation of for-profit colleges. At a minimum, that regulation should put the worst performers out of business.

While the risk for students in subprime higher education is well known, it is not so well understood that there is a federal policy of fostering career colleges. This is not just a de facto policy resulting from the considerable talent of the for-profit sector in sucking up federal student aid dollars. Rather, the policy is by federal design. After noting a recent tripling in for-profit college enrollment, the United Stated Department of Education stated in July of 2010:

This trend is promising and supports President Obama’s goal of leading the world in the percentage of college graduates by 2020. The President’s goal cannot be achieved without a healthy and productive higher education for-profit sector.

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6 Pew Research Center, Is College Worth It? (2011) [http://pewresearch.org/pubs/1993/survey-is-college-degree-worth-cost-debt-college-presidents-higher-education-system](http://pewresearch.org/pubs/1993/survey-is-college-degree-worth-cost-debt-college-presidents-higher-education-system) (presenting evidence that, despite increasing dissatisfaction with the price, employment and income go up with a college education, as well as health, happiness, rates of marriage, sense of personal intellectual development and other forms of personal satisfaction, and prospects of graduates’ children). The dissatisfaction with the price is in part a matter of decreased public subsidy, particularly for public universities. See infra Part IIC concerning the difference between the sticker price and the price paid in different sectors of higher education; for-profit higher education has a higher net price than public university education and than much of private nonprofit higher education. Price, however, must be distinguished from cost; the cost of for-profit education is relatively low, compared to prime high education, which involves a great deal of public and philanthropic subsidisation. See infra Part IV.

7 There is a great deal of variation within the various sectors of higher education, whether for-profit, public or private nonprofit. See Amanda Harmon Cooley and Aaron Cooley, From Diploma Mills to For-Profit Colleges and Universities: Business Opportunities, Regulatory Challenges, and Consumer Responsibility in Higher Education, 18 S. Cal. Interdisciplinary L. J. 505 (2009) (discussing variation in success of for-profit colleges). See also U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43654 (discussing variations in default-completion ratios within sectors). Nonetheless, targeted regulation of the for-profit sector based on loan repayment can be justified in light of these schools’ different missions. The Pew Report, supra note 6 at [end of chapter 1], discusses the difference in the missions of the schools through the lens of what their presidents’ say about them: “Seven-in-ten heads of four-year public and private colleges emphasize intellectual and personal growth, while about two-thirds of the heads of two-year and for-profit colleges emphasize career preparation.” Career preparation is not easy to measure, but it is simple compared to measuring intellectual and personal growth.

Regulation of for-profit colleges has been very light, and a planned step-up in federal oversight will still be weak, as the U.S. Department of Education concedes. The regulatory challenge is to ensure the quality of the education, and regulating quality is difficult at best.

This article questions the federal policy of relying heavily on career colleges to increase the level of higher education in the population. It also seeks to highlight the irony of setting low performance standards for the for-profits while providing insufficient debt relief for the substantial numbers of their students who do not benefit from the education and who end up with unmanageable federal and private student loans and lack of access to a bankruptcy discharge.

If career colleges cannot be expected to reduce their default rates to the levels of other sectors of higher education, their former students should not be hounded to the grave for repayment. In its gainful employment rule, set to go into effect July 1, 2012, the U.S. Department of Education took the position that high levels of federal student loan default are tolerable; the rule allows schools with repayment rates of only 35 percent over a three-year period, meaning the rest are not repaying any principal, to remain eligible to receive federal student aid funds. The agency did so despite explicitly recognizing that loans for education at for-profit schools are very high risk for any individual student.

This article first describes the business model of for-profit colleges in Part I. In Part II, it explains the federal government’s role in promoting them and also situates the current government position in the sweep of federal policy concerning for-profit higher education over

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9 U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43657 (concerning a history of “barest minimum enforcement” of a statutory requirement that for-profit colleges prepare students for gainful employment in a recognized occupation; colleges have just been required to check a box so stating) and at 43620 (in a proposed regulation, targeting schools at which “it becomes unambiguous that a program’s debt levels are excessive.”) That proposed regulation was later watered down. See U.S. Department of Education, Program Integrity: Gainful Employment—Debt Measures, Fed. Reg., Vol. 76, No. 113 (June 13, 2011). See infra Part III.

10 Marc T. Law and Sukkoo Kim, Specialization and Regulation: The Rise of Professionals and the Emergence of Occupational Licensing Regulation, 65 J. OF ECON. HISTORY 723 (2005) (discussing difficulty of regulation to ensure quality under conditions of asymmetric information, in which the seller understands quality better than the consumer).


13 U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43622 (noting “no guarantee for the individual”).
the last half century.\textsuperscript{14} Finally, Part III compares the bubble in subprime higher education to that in subprime mortgages. The volume of loans for subprime higher education does not approach the volume of subprime mortgages,\textsuperscript{15} but the human cost of both credit complexes is high. There are many other similarities. These include, as already mentioned, high risk of default and the demographics of the borrowers. Also striking is how both types of loan are promoted as a way to achieve the American dream, yet the dream too often proves unattainable. The article ends by advocating more aggressive regulation that puts more nonperforming for-profit institutions out of the business of living on a federal dole.

The subprime higher education bubble appears to be deflating as the industry hunkers down to ride out a long period of economic doldrums.\textsuperscript{16} Student loan defaults in this sector have spiked, but this is not the industry’s prime problem now. When borrowers default on federal student loans, the colleges already have the money; the bailout is prepackaged. The current problem for the industry is declining enrollments and thus a decline in new revenue. The career colleges are running out of students, just as the subprime mortgage industry ran out of borrowers. The word is out about the poor results of many career colleges and at least for a time, fewer people are being suckerized into a bad bet (and the colleges appear to be deliberately reducing recruitment to avoid more aggressive regulation in the short term). But many former students still have to cope with the consequences of the bubble. They gambled on the dream of a better life by getting a college education and ended up worse off, with big nondischargeable debt and no improvement in job prospects. Beyond that, there is the question whether it is wise policy to try to achieve national educational goals by funneling federal dollars into institutions that specialize in evading regulation. Regulation needs to be put in place now to prevent a resurgence of the for-profit sector as the economy recovers.

II. The Business Model of For-Profit Colleges

For-profit colleges built their business model on rapid growth,\textsuperscript{17} fueled by aggressive recruiting\textsuperscript{18} and high use of federal student aid (both grants and loans).\textsuperscript{19} This model has produced large student debt burdens and high defaults.\textsuperscript{20} The defaults are symptomatic of an underlying

\textsuperscript{14} See infra Part IIE.
\textsuperscript{15} See infra Part IV.
\textsuperscript{16} See infra Part IIF.
\textsuperscript{17} See infra Part IIA.
\textsuperscript{18} See infra Part IIB.
\textsuperscript{19} See infra Part IID.
\textsuperscript{20} See infra Part IIE.
pathology: although the mission of career colleges is to improve employability and earnings, placement in good jobs has not lived up to recruiters’ claims.\(^{21}\)

A. Enrollment growth.

As noted at the outset, enrollment in the for-profit higher education sector rose rapidly in the last decade: from the fall of 2000 to the fall of 2009, fulltime students in degree-granting, for-profit schools grew from 366,000 to 1.5 million, an increase from 4 percent to 11 percent of full-time students.\(^{22}\) When parttime students are also included, the growth was from 3 to 9 percent of all college students.\(^{23}\) Indeed, headcounts of both full-time and part-time students show that the number of individuals involved is much larger than the number of full-time students or full-time equivalents. In 2009-2010, 3.3 million undergraduates and 431,000 graduate students attended for-profit schools.\(^{24}\)

It is a misconception that for-profit schools operate mostly in the sphere of shorter programs.\(^{25}\) Students in the for-profit sector are primarily enrolled in four-year degree programs (61 percent), with 24 percent of this sector’s students in two-year institutions and 15 percent in less-than-two-year schools.\(^{26}\) In addition, most students at for-profit colleges go to school full-time, indeed at a higher rate than college students as a whole. Among undergraduates in the for-profit sector, 77 percent are enrolled full-time, while for all undergraduates, 64 percent are full-time students.\(^{27}\) For-profit graduate programs also grew rapidly in recent years, with their share of degrees rising

\(^{21}\) Id.

\(^{22}\) Sandy Baum & Kathllen Payea, Trends in For-Profit Postsecondary Education: Enrollment, Prices, Student Aid and Outcomes (2011) [hereinafter Trends in For-Profit Postsecondary Education].

\(^{23}\) Id. See also, College Board, TRENDS IN COLLEGE PRICING (2010) at 25, Figures 17A and 17B (showing full-time and part-time enrollments in the various sectors from 2000 to 2009).

\(^{24}\) National Center for Education Statistics, POSTSECONDARY INSTITUTIONS AND PRICE OF ATTENDANCE IN THE UNITED STATES: 2010-11; DEGREES AND OTHER WARDS CONFERRED: 2009-10; AND 12-MONTH ENROLLMENT: 2009-10 (2011) [hereinafter, NCES, POSTSECONDARY INSTITUTIONS (2011)] at 14, Table 6 (counting enrollment by headcount, which means counting part-time students the same as those going to school full time, and showing 3.3 million undergraduates and 431,000 graduate students at for-profit colleges in 2009-10) and at 15, Table 7 (counting full-time-equivalent enrollment and showing 2.3 million undergraduates and 246,000 graduate students at for-profit institutions).

\(^{25}\) Trends in For-Profit Postsecondary Education, supra note 22, at 1.

\(^{26}\) Id.

\(^{27}\) Id.
from 1 to 7 percent of all graduate degrees awarded in the decade ending in the academic year 2007-2008.\(^{28}\)

B. Aggressive recruiting.

Recruiting by for-profit colleges ranges from aggressive to deceptive and even fraudulent. In a 2010 study, investigators from the Government Accountability Office posed as prospective students and registered to receive information on web sites; they quickly received numerous telephone calls, as many as 24 in the first 24 hours and 182 within a month.\(^{29}\) The GAO investigators also posed as in-person applicants and found that all 15 for-profit schools they visited engaged in “deceptive or otherwise questionable statements,” such as misinformation about accreditation, questionable information about graduation rates, misrepresentations that students were guaranteed employment upon completion and at salaries that few could actually expect to garner, and deceptive information about the duration and cost of the colleges’ programs.\(^{30}\) Although some accurate, helpful and reasonable information was given, advising applicants of risks, the investigators encountered argumentative and scolding recruiters, marketing techniques that required applicants to enroll before getting information, and overall hard-sell tactics.\(^{31}\)

The worst practices found by the GAO involved encouragement to falsify information on federal financial aid forms (four of the 15 schools visited).\(^{32}\) Applicants were also led to believe that student loans would not be collected and were aided in cheating on application tests (by coaching or by being permitted extra time or a retest to get a higher score).\(^{33}\)

C. High net price.

To compare tuition and fees of various sectors, one has to take into account the difference between published prices and what students pay after grant aid from all sources, public and

\(^{28}\) Id.


\(^{30}\) \textit{Id.} at 9-11

\(^{31}\) \textit{Id.} at 12-14.

\(^{32}\) \textit{Id.} at 7-8, 12,

\(^{33}\) \textit{Id.} at 12.
private. The sticker price is not the price paid. Although average published prices for tuition and fees are up across the board in recent years, net prices actually declined in the five years from 2005-2006 to 2010-2011 due to increases in federal and institutional grant aid.\textsuperscript{34} Only about a third of college students pay the full published prices at nonprofit and public institutions.\textsuperscript{35}

The average published tuition and fees for full-time undergraduates in 2010-11, gathered by the College Board, were:\textsuperscript{36}

\begin{tabular}{|c|c|}
\hline
Type & Price \\
\hline
Public two-year & $2,713 \\
Public four-year (in state) & $7,605 \\
Private for-profit & $13,935 \\
Private nonprofit four-year & $27,293 \\
\hline
\end{tabular}

Again, these published prices are not the same as what students actually pay. Here is the College Board’s estimated net average payment for tuition and fees for 2010-11, once grant aid is taken into account\textsuperscript{37}:

\begin{tabular}{|c|c|}
\hline
Type & Payment \\
\hline
Public two-year & -$670* \\
Public four-year (in state) & $1,540 \\
Private nonprofit four-year & $11,320 \\
\hline
\end{tabular}

*The figure is negative because grant aid on average exceeds tuition and fees; the excess can go to other expenses, such as books and room and board.

Students received on average the following annual amounts in grant aid from all sources: $3,400 at two-year public schools, $6,100 at public four-year colleges, and $16,000 at private nonprofit four-year schools.\textsuperscript{38}

\begin{thebibliography}{99}
\bibitem{34} College Board, \textit{TRENDS IN COLLEGE PRICING}, \textit{supra} note 23, at 4, 8.
\bibitem{35} \textit{Id.} at 8.
\bibitem{36} \textit{Id.} at 2. \textit{See also} NCES, \textit{SECONDARY INSTITUTIONS}, \textit{supra} note 24, at Table 3, reporting somewhat different tuition and fees, but based on figures not weighted by enrollment, as the College Board figures are, making the latter a better indicator of average sticker price.
\bibitem{37} College Board, \textit{TRENDS IN COLLEGE PRICING}, \textit{supra} note 23, at 15.
\bibitem{38} \textit{Id.}
\end{thebibliography}
Good data are not readily available concerning the net price at for-profit schools, but the grant-aid at these schools has been lower on average because they do not offer much institutional grant aid. In 2007-08, for example, fulltime undergraduate students at for-profit colleges received on average about $140 in institutional grant aid, compared to over $7,000 at private nonprofit colleges. Total grant aid from all sources for full-time dependent students at for-profit schools, 75 percent of the grant aid being federal grants, averaged $3,610, compared to $7,050 on average in 2007-08 at four-year public colleges, 25 percent of it federal. It should be remembered that public universities have lower tuition and fees to begin with than for-profit institutions. At private nonprofit institutions in 2007-08, grant aid for fulltime dependent students ranged widely across the four quartiles of pricing, with average grants in each group, from lowest- to highest-priced schools, as follows: $7,700, $14,550, $17,620, $21,860. Overall, the average net price at either a two-year or a four-year public school was significantly lower than at a for-profit school, and even at private nonprofit colleges, the average net price is lower or only moderately higher in the lower two quartiles of pricing. Private nonprofit schools received only nine percent of their grant aid from the federal government in 2007-08. Even at the higher-priced nonprofit schools, need-based grant aid for low-income students often makes this a cheaper option, and one that comes with better outcomes for those qualified for admission.

D. Reliance on federal grant aid and student loans.

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39 Id. at 7.

40 Trends in For-Profit Postsecondary Education, supra note 22, at 4, Figure 3 (showing that in 2007-08, 73% of grant aid at four-year nonprofit schools and 34% at four-year public schools came from institutional sources, while only 7% of grant aid at for-profit schools was from institutional sources).

41 Id. at 4

42 Id. at 4, Figure 3 and Table 4.

43 Supra note 36 and accompanying text.

44 Trends in For-Profit Postsecondary Education, supra note 22, at 4, Table 4.

45 Id. (showing the following net average prices, including all expenses, in 2007-2008: $6,480 for two-year public schools, $9,030 for public four-year schools in-state, $16,510 for for-profit institutions, and the following four average net prices, by pricing quartile, for private nonprofit schools: $12,030, $17,400, $20,570, and $24,140).

46 Id. at 4, Figure 3.

47 Some private nonprofit colleges have set family income levels below which students pay nothing for tuition and fees. [Get cites.]
A key feature of the for-profit college business model is maximum use of federal student aid, both grants and loans. In 2009, the five largest for-profit institutions received 77 percent of their revenues from federal student aid programs.\footnote{U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43618.}

The 10 percent of all FTE postsecondary students enrolled in for-profit schools in 2008-09 received 24 percent of federal Pell Grants.\footnote{Trends in For-Profit Postsecondary Education, supra note 22, at 3, Table 2.} They also received 28 percent of the unsubsidized and 25 percent of the subsidized Stafford loans, compared to 6 and 8 percent, respectively, for the 27 percent of all FTE students at public two-year institutions.\footnote{Id. and College Board, TRENDS IN STUDENT AID 4 (2010).} The federal funds going to for-profit schools in that one year amounted to more than $4 billion in Pell grants and $20 billion in federal student loans.

E. Higher debts and higher default rates; lower graduation and repayment rates.

For-profit college students take out more loans than students in public or private nonprofit institutions and fail to repay at higher rates, despite the premise of career-college education that its mission is to add income that will allow students to repay student loans.\footnote{U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43657 (discussing industry spokesman’s argument that “the students receiving loans will, in almost every case, be enabled to repay them out of the added income”).} Among completers of bachelor’s programs in 2007-2008, for example, the median debt of the for-profit college students (including nonborrowers) was $31,000, compared to $16,000 at private nonprofit schools and $7,000 for public institutions.\footnote{Id. at 43647, Table A1 (figures in text rounded to nearest $1,000).} For completers of two-year associate’s degree programs the same year, the disparity was particularly pronounced, with the median debt being zero at public schools, while it was $18,000 at for-profit schools and $10,000 at private nonprofit institutions.\footnote{Id. (figures in text rounded to nearest $1,000; the public institution median was in fact zero, not just less than $500).} The zero debt median at public two-year programs is due to the very low tuition at many community colleges, so that students can often pay as they go along from income and grants.\footnote{GET CITE (80 percent of students in two-year public programs do not take out student loans—2009 College Board Student Aid pub?).} For-profit two-year programs, in contrast, are typically at least as expensive per year as four-year for-profit programs. The GAO investigation discussed above noted that a comparison of close-by for-profit and public two-year programs reveals instances of for-profit programs that
are 6 to 13 times more expensive. Another useful comparison is the percentage of students in the various sectors who receive bachelor’s degrees who are more than $30,000 in debt; in 2007-08, the figure was 57 percent of for-profit four-year degree recipients, while it was 25 percent at private nonprofit schools and 13 percent at public schools.

Former students of for-profit colleges also have high default and low repayment rates, in part driven by low graduation rates. First, avoiding default is not the same as repaying. Many students become delinquent (under expansive program definitions) without being counted as defaulting, and others get deferments and forebearances, which also are not counted as defaults. A study of student loan borrowers in all higher education sectors who entered repayment in 2005 found that over the next five years, 37 percent repaid on time, 23 percent postponed repayment by deferment or forebearance and thus avoided default, 26 percent were delinquent without being counted as in default, and 15 percent defaulted, under program definitions that generally do not count a delinquency as a default for at least 270 days. In sum, the debtors who went into default or delinquency exceeded those who paid on time, not counting those who got deferments or forebearances.

When these figures are broken down by higher education sector, differences between those who attended for-profit schools and other sectors are dramatic among students who attended four-year institutions, with combined total delinquencies and defaults for the 2005 group of: public (34 percent, broken down 24/10 percent for delinquency/default); private nonprofit (28 percent, broken down 20/8 percent) and for-profit (53 percent, broken down 29/24 percent). The figures are closer in a comparison of two-year institutions, with combined total delinquencies and defaults of: public (60 percent, broken down 36/24 percent) and for-profit (63 percent, broken down 27/36 percent). There is a big difference in delinquencies and defaults for borrowers who complete degrees as opposed to those who do not, and students at for-profit four-year programs leave within three years without enrolling elsewhere at more than three times the rate

55 Kutz, supra note 29, at 17.
56 U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43618.
57 See Alisa F. Cunningham and Gregory S. Kienzl, DELINQUENCY: THE UNTOLD STORY OF STUDENT LOAN BORROWING (Institute for Higher Education Policy March, 2011) at 4-6 (summary of results concerning payment on time, deferment and forebearance, delinquency, and default for debtors who entered repayment in 2005 and were followed for five years) and 8 & n. 1 (noting that student loan debtors are not generally considered in default until 270 days of delinquency or 360 days for some loans, such as direct loans from the U.S. Dept. of Education).
58 Id. at 23, Table 5.
59 Id.
60 Id. at 24, Table 6.
of students at public and private nonprofit four-year programs. While students at public two-year schools leave without a degree at a higher rate than students at for-profit schools, most of the former do not have student loan debt.

Each fiscal year, the government publishes official national student loan “cohort default rates,” which have risen in recent years for all sectors. From fiscal year 2008 to 2009, the overall default rate, published by the government in September of 2011, rose from 7 to 8.8 percent, and for for-profit schools, the increase was from 11.6 to 15 percent. These figures are primarily useful for showing trends and comparing sectors because, as discussed above, they are based on program definitions of default that exclude delinquencies, deferments and forebearances, and they count only defaults on loans that came due in one fiscal year and defaulted by the end of the next fiscal year, but not defaults that occur later.

Other measures better capture the risk of attending for-profit institutions. For every 100 students who completed a program at a public or nonprofit school in 2007-08, there were four former students who entered repayment in 2008 and defaulted the next year, while at for profit institutions, there were 18 defaulters per 100 completers, that is, more than four times as many defaulters as in the other sectors. When only four-year programs are considered, the defaulters to completers ratio was 25 in 100. Another measure is how many borrowers are repaying any principal on their loans within three years after leaving school: the figures for fiscal year 2006 through 2009 were 80 percent of borrowers who attended public schools, 88 percent who

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61 U.S. Department of Education, Program Integrity: Gainful Employment; Proposed Rule, supra note 4, at 43655, Table C (showing 34 percent rate for for-profits, 10.8 percent for publics, and 10.0 percent rate for private nonprofits of leaving a four-year school within three years without enrolling elsewhere).

62 Id. at 43656, Table C (showing that 34.1 percent for students at public two-year program leave within three years without a degree and without enrolling elsewhere, compared to 26.6 percent for students in for-profit two-year programs).

63 See supra note 53 and accompanying text.


65 Id. (noting that official FY 2009 national student loan cohort default rate is a snapshot of the borrowers whose repayments came due between Oct. 1 2008, and Sept. 30, 2009, indicating the percentage that defaulted before Sept. 30, 2010, and not including defaults after that time).

66 Id. at 43652 & Chart B.

67 Id. at 43653-4 & Chart C (also noting that this default to completion ratio indicates “substantial barriers to providing value to enrollees”).
attended nonprofit institutions, and only 55 percent in the case of career colleges.\textsuperscript{68} Looking at the same period and applying a test of percentage of the sector that had at least a 35 percent repayment rate, the figures were 89 percent for four-year public and nonprofit institutions, 73 percent of public two-year institutions, and less than 60 percent of all for-profit schools.\textsuperscript{69} The repayment measure has been given a central role in the new gainful employment regulation, discussed in Part IIIX below.\textsuperscript{70}

F. How the for-profits spend their budgets.

[Discuss low expenditures for instruction and high expenditures on executive salaries, marketing, and lobbying.]

G. Recent declining enrollment.

[For-profit colleges have been reporting declining enrollments since late 2010. This seems to be due to a combination of decreased interest by prospective students but also reduced recruiting by this sector as it attempts to ride out negative publicity, increased regulatory attention and the bad economy.]

[The following two parts will undergo substantial revision and elaboration]

\textbf{Part III. The Weak Regulatory Framework and Lack of Relief for Debtors}

A. History of federal support for for-profit institutions.

The Higher Education Act of 1965 established the Guaranteed Student Loan Program.\textsuperscript{71} Proprietary school students became eligible for this program in 1972.\textsuperscript{72} Subsequent changes in 1979 made private student loan lenders more willing to lend to students at for-profit schools by removing a federal interest subsidy limit and thus encouraging the lenders to take the risk.\textsuperscript{73} As a result, proprietary schools grew, and by the late 1980s, they had become the focus of

\begin{footnotesize}
\textsuperscript{68} See \textit{id. at 43654.}

\textsuperscript{69} Id.


\end{footnotesize}
congressional oversight attention and class action litigation alleging that they were aggressively recruiting the poor and the homeless from welfare lines and laundromats and using help-wanted ads promising better jobs.\textsuperscript{74} Interestingly, as today, the risk of default on these loans was compared to a recent financial meltdown; in the earlier era, it was the savings and loan crisis,\textsuperscript{75} and today, it is the mortgage crisis. In other words, we have been here before in witnessing the burgeoning of a for-profit high education sector that focused more on harvesting federal student aid dollars than on delivering results to students.

The problems with proprietary schools in the 1980s led to new regulation using cohort default rates. [Explain.] Large numbers of the earlier for-profit schools were put out of business by the withdrawal of federal student aid in the 1990s. GAO Report, July 1999 re Default Rates. The for-profit schools in that earlier era were largely small and local and often focused on non-degree training for a trade, albeit with poor results. As trade schools closed down, the for-profit sector morphed into its current incarnation, beginning in the 1990s and really taking off after the turn of the century. The new for-profit sector is characterized by large institutions offering conventional college degrees and organized as publicly-traded companies, with ever-increasing sophistication in rent-seeking and regulatory evasion. The DOE imposed a 90 percent limit on the percent of a program’s revenue that can come from HEA funds and cohort default regulation also continues to apply, but only recently has the department proposed to look for more positive results as a condition of eligibility for federal student aid funds.

B. New gainful employment rule.

On June 13, 2011, the U.S. Department of Education (DOE) published its final Gainful Employment Rule (GER), culminating a two-year regulatory process.\textsuperscript{76} DOE published a proposed rule on July 26, 2010,\textsuperscript{77} and it then received 90,000 comments, 75 percent of them negative.\textsuperscript{78} Meanwhile, members of Congress also opposed the rule.\textsuperscript{79} Given this backdrop, it is


\textsuperscript{75} \textit{Id.} at 639.

\textsuperscript{76} 74 \textit{Federal Register} 46399 (Sept. 9, 2009), announcing the beginning of the process.


\textsuperscript{78} U.S. Department of Education, Program Integrity: Gainful Employment—Debt Measures, \textit{supra} note 9, at 34390 (also noting that many comments were not specific, stated only general opposition or support for the proposed rule, appeared generated by petition-drives and letter-writing campaigns, and expressed general support for making sure that student loans are affordable).
perhaps surprising that any rule was promulgated, but DOE pressed on, simplifying the rule, reducing its requirements, and setting an effective date of July 1, 2012. The industry, however, has brought suit to block it, arguing that DOE lacks authority make the rule.

As finally promulgated, the GER sets up two tests, and a program that meets either one remains eligible to receive Title IV Higher Education student aid funds, which include both grants and federal student loans. The first test concerns the repayment rate of former students, and the second focuses on the debt-to-income (DTI) ratios of completers of programs.

The student loan repayment rate of a program is not the same as the rate of former students not in default. This is because default is defined narrowly as not meeting DOE requirements. Those not counted as in default include former students who get deferments and forebearances, and also those who are delinquent but not yet in default (defined as a up to a year of delinquency). Under the repayment test, schools will remain eligible to receive for federal student aid if 35 percent of their former students were repaying at least some principal on their loans (even $1).

Alternatively, a program can remain eligible under either part of a two-pronged DTI test. The typical annual loan payment of students must be 12 percent or less of annual earnings or 30 percent or less of discretionary income. Only if a program fails both of these tests for three out of four years does it lose eligibility.

[This section will further discuss the proposed rule published in 2010, the substantial cutback in the rule as promulgated in 2011, the Department of Education’s concessions to minimize the impact on the for-profit industry, and the industry lawsuit to stop the rule’s implementation as scheduled in 2012. It will describe the predicted impact of the rule as far as loss of eligibility]


82 U.S. Department of Education, Program Integrity: Gainful Employment—Debt Measures, supra note 9, at 34408-34410 (discussing who is counted as repaying).

83 See 34 CFR 668.7 (setting up a complex formula to make this calculation).

84 Id. (using either median or mean for both the annual loan payment and income figures).

for federal funds by some schools and the objections of the industry discussed both by DOE and in the complaint in the industry’s lawsuit to block the rule.]

C. Lack of sufficient debt relief in bankruptcy or otherwise.

[This section will summarize the state of the law on nondischargeability of student loans in bankruptcy. Student loans are nondischargeable, absent undue hardship. There have been many twists in the history of nondischargeability of these loans. Five year, eight year, no time limit on nondischargeability. Added private student loans.

The term “mortgage” works metaphorically as applied to educational loans in light of the difficulty of obtaining debt relief; to the extent of nondischargeability of this debt in bankruptcy or otherwise, human capital is mortgaged for life.

The section will also discuss the debt relief programs of the DOE, which recognizes the growing problem of student loan overindebtedness but continues to refer these loans for collection and to provide minimal relief.]

IV. Assessing the Government’s Role

A. The Analogy to Subprime Mortgages

There are some obvious similarities between the subprime mortgage crisis and the problem of subprime higher education. In both cases, there has been heavy selling of the American dream, whether the dream is of owning a home or becoming a college graduate. Furthermore, predatory lending has been a feature of each phenomenon, involving a lack of care about or analysis of ability to pay and benefit. The poor, minorities, and the unsophisticated were targeted in both bubbles. Both phenomena have led to high debt, high default rates, and long-term impact on borrowers’ financial well-being and access to and cost of future credit.

The Dodd-Frank Act of 2010 provides for regulation to make sure that mortgage lenders have “skin in the game” for risky mortgages. There has been a similar problem of subprime higher educational institutions having little or no stake in their students’ success. The career colleges have a nearly perfect system of avoiding skin in the game. When students get federal grant aid and student loans to attend college, the schools get paid up front and do not bear the loss when former students default later. Some for-profit colleges give or arrange for private student loans on top of federal student aid, but this may be primarily to avoid problems with the 90 percent limit on revenues from federal student aid. To evade that limit, for-profit colleges can raise tuition, provide private student loans of just over 10 percent, and not care much if they collect on the private loans. Another strategy is enrolling some military and former military personnel
whose loans do not come from federal higher education funding and thus don’t count for purposes of the 90 percent limit on revenue from federal student aid funds.\textsuperscript{86}

Both subprime mortgages and subprime higher education were enabled by a lack of effective regulation. The cluelessness of rating agencies about the risks of subprime mortgages is analogous to the lack of effective oversight of for-profit colleges by educational accrediting organizations, which the career colleges have captured and manipulated. Taxpayers have paid for a bailout of subprime mortgage lenders and investors, but in the case of subprime higher education, the prepayment of federal grant and loan funds to the colleges makes for a prepackaged bailout. In this way, the federal role in subprime higher education is even worse than in the subprime mortgage crisis because it involves a preplanned pipeline of federal funds into institutions that generate high risks for borrowers.

There is also an interesting comparison in the treatment of unmanageable debt in bankruptcy. Home mortgage debt is dischargeable so that the borrower is not personally liable, but it must be paid in full to retain a home, absent agreement of the lender to a modification or unusual circumstances such as inclusion of collateral other than the home.\textsuperscript{87} Thus a debtor who is willing to give up a home can discharge home mortgage overindebtedness. Student loans are nominally unsecured, but they are effectively secured by human capital and by nondischargeability; the law does not provide the release available with home loans. One cannot give back a worthless education and thus walk away from it. A debtor can be hounded to the grave for student loan debt, no matter its ineffectiveness in improving the debtor’s income. So long as the debtor is not permanently disabled and is able to maintain a basic lifestyle, student loan debt remains nondischargeable for life.\textsuperscript{88}

While subprime higher education is worse than subprime mortgages both in the prepackaging of the bailout and in the long-term indenture of former students, there is one way in which the student loan problem is not as bad. It is not as big. While private student loans are securitized, and there is some credit default swap activity around student lending, the total dollars involved make for less risk to the financial system. Losses to taxpayers are substantial, but not as big as in the mortgage bailout.

B. Questioning Reliance on For-Profit Higher Education as the Means to Expand Levels of College Graduation


\textsuperscript{87} 11 U.S.C. 1325(b)(2) and (5).

\textsuperscript{88} Brunner tests
In the post-war decades from the 1950s to the 1970s, it became common to think in terms of elite, mass, and universal higher education (Trow 1970). These three categories roughly map onto the three tiers of the California higher education system—the University of California (elite); the California State Universities (mass); and community colleges (universal). The categories can also be described in terms of percentages of the population, that is up to 15 percent (elite), 16-50 percent (mass), or above 50 percent (universal). Private nonprofit universities and colleges also play a role in each of these categories.

The federal government has embraced for-profit higher education as part of a push for a higher rate of college graduation. The primary reason is the low cost of production. Although for-profit students often pay more, the cost per student is half of publics and quarter of nonprofits when subsidies from public and private sources are included. For-profit education could be even cheaper—only 9 percent of revenue is spent on instructions. The rest goes to high compensation of executives (many of them former politicians), costs of lobbying, marketing, and profit for investors.

[Discuss how community colleges work by comparison; public subsidy, low or no debt, low risk to students even if they don’t complete programs because they typically pay as they go rather than borrow.]

Taking on a mortgage for a university education has become a common feature of late adolescent life in America, and for-profit college graduates have the highest debt. In 2010, total student loan debt volume rose above that of credit card debt for the first time, as a result of increases in the former and decline in the latter in the wake of credit constriction brought on by the Great Recession. College freshmen reported record levels of stress as they worried about their career prospects in relation to the debt they were incurring (HERI 2010). The implications for household finance of entering adult life with an educational mortgage are profound, even for those who do not obviously fail. Among borrowers for postsecondary education, 48 percent say having to repay student loans makes it harder to pay bills and make ends meet and 25 percent say it is harder to buy a home (Pew 2011). While there is plenty of room for soul-searching by leaders of conventional higher education institutions about the cost-benefit equation for students, the debt burden is least manageable for students who attended for-profit colleges. Under a principal of worst things first, it makes sense to get tougher on for-profit colleges, shutting more down to minimize their negative outcomes.

Sadly, the growth of predatory for-profit higher education has been dramatically fueled in the last decade by an infusion of federal dollars in the form of grant aid and direct student loans. The for-profit sector is offering subprime higher education characterized by high net price (although not cost) and high risk of producing only overindebtedness. The idea of a subprime higher education sector captures well many of its features as well as the similarities to subprime mortgages, in terms of cost, risk, value, and the population to which they have been marketed.
Looking back on the housing bubble, we can see that the push for expanded ownership went too far. Many of those who bought homes with subprime mortgages became owners in name only; in reality, they had no equity and effectively ended up paying very high rent or defaulting and taking a blow to their credit scores. It would have been better if regulation had prevented the bubble. A very similar argument can be made about subprime higher education. Just as some of the new homeowners would have been better off remaining renters, some people would be better off not going to college, particularly for-profit colleges. Predatory lending will not get us to universal college education. Shutting down more predatory colleges is a sound strategy to contain the damage.