Overview of President Obama's FY 2016 Budget Request

On February 2, 2015, President Obama released his fiscal year (FY) 2016 budget request to Congress. A fact sheet from the Office of Management and Budget states that the budget “is designed to bring middle class economics into the 21st Century.” The budget calls for $3.99 trillion in spending and $3.53 trillion in revenue, resulting in a $474 billion deficit in FY 2016. Of note, the Congressional Budget Office estimated that the deficit for FY 2016 will be $467 billion, assuming no change to current law.

The budget request includes a number of new spending initiatives. First, the budget provides a $74 billion increase in discretionary spending, in order to break the sequestration caps imposed by the Budget Control Act of 2011. The increase would be split evenly between defense and non-defense discretionary spending. The Department of Education budget calls for $70.7 billion in discretionary spending, a 5.4 percent increase over the current year. Among the new mandatory spending for education are proposals to support Preschool for All ($66 billion over 10 years), a “Teaching for Tomorrow” program ($1 billion a year for five years), tuition-free community college ($60.3 billion over 10 years), an extension of the Pell Grant CPI increase ($29.7 billion over 10 years), and a College Opportunity and Graduation Bonus program ($5.9 billion over 10 years).

Many of the new spending initiatives would be paid for through reforming the “broken tax code,” including a new tax on large banks, increased capital gains taxes, a limit on the value of deductions and tax preferences for higher-income taxpayers (couples with incomes above $250,000), enactment of the “Buffett Rule,” and ending the “stepped-up basis” on inherited wealth. The budget also includes a $478 billion, six-year surface transportation reauthorization proposal paid for by taxing amounts held overseas by U.S. corporations. The budget also calls for increased revenues from savings in health care and increased revenues stemming from immigration reform. While the Committee for a Responsible Federal Budget criticized the budget request for not addressing the nation’s long-term budget problems, it commends the President for adhering to pay-as-you-go principles by fully paying for all of his new initiatives.

The following is a summary of the budget’s provisions that impact student financial aid:

**Pell Grants**

- The budget makes several reforms to the Pell Grants that are intended to ensure the program keeps pace with inflation. These include:
  - Strengthening academic progress requirements;
  - Limiting the receipt of additional disbursements by recipients who are not advancing academically;
  - Allowing students enrolled in eligible career pathways to receive the maximum award;
  - Moving Iraq Afghanistan Service Grants to the Pell Grant program to allow them to get full, non-sequestered Pell Grant awards;
  - Extending the inflationary increase to the maximum Pell Grant beyond the end of the 2017-2018 award year.
Community College Initiative

- The budget calls for a new federal-state America’s College Promise initiative that would provide free community college tuition.
  - Under the program, students must attend at least half-time, maintain a 2.5 grade point average while in college, and make steady progress toward completing their program.
  - States must commit to continue existing investments in higher education, coordinate high schools, community colleges, and 4-year institutions to reduce the need for remediation and repeated courses, and allocate a significant portion of the funding based on performance.
  - Community colleges must offer academic programs that fully transfer to public 4-year colleges and universities.
- The budget increases a new College Opportunity and Graduation Bonus program that would reward colleges that admit and graduate on-time Pell Grant recipients. The proposal would be funded with mandatory funds.

Federal Student Loans

- The Budget would reform the Pay-As-You-Earn (PAYE) income-driven repayment (IDR) plan to target the program at the neediest borrowers and protect against institutional practices that may further increase student indebtedness. PAYE would become the only IDR plan for new borrowers beginning July 1, 2016. The PAYE changes include:
  - Eliminating the standard payment cap under PAYE;
  - Calculating payments for married borrowers filing separately on combined household Adjusted Gross Income (AGI);
  - Establishing forgiveness after 25 years (rather than 20) for borrowers over the aggregate loan limit for independent undergraduate students;
  - Capping the amount of interest that can accrue when the monthly payment is insufficient to cover interest;
  - Capping Public Sector Loan Forgiveness (PSLF) at the loan limit for independent undergraduate students; and
  - Preventing payments made in non-income driven repayment plans from being applied toward PSLF.
- The budget estimates that this proposal would save $14.5 billion over 10 years. These savings would be reinvested in student aid spending, specifically to extend the CPI indexing for the Pell Grant.
- Interesting, while the budget calls for reforming PAYE and reducing the program’s long-term costs, the Department of Education is about to embark on a negotiated rulemaking which may expand the pre-existing program. The budget document states that through negotiated rulemaking: “By the end of calendar year 2015, all student borrowers would be eligible for some type of income-driven program that caps student loan payments at 10 percent of their discretionary income and forgives any remaining balance after 20 years of payments.”
- No changes are proposed that would directly affect guaranty agencies, though any expansion of PAYE could accelerate consolidation into Direct Loans.
Projected Student Loan Default Rates

- The expected lifetime default rates for Direct Loans disbursed in 2016 are shown on the following table:

<table>
<thead>
<tr>
<th>Direct Loans</th>
<th>2016 est.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stafford Loans</td>
<td>22.28%</td>
</tr>
<tr>
<td>Unsubsidized Stafford</td>
<td></td>
</tr>
<tr>
<td>Undergraduate</td>
<td>22.82%</td>
</tr>
<tr>
<td>Graduate/Professional</td>
<td>6.71%</td>
</tr>
<tr>
<td>PLUS</td>
<td></td>
</tr>
<tr>
<td>Parent PLUS</td>
<td>10.03%</td>
</tr>
<tr>
<td>Grad PLUS</td>
<td>6.05%</td>
</tr>
<tr>
<td>Consolidation</td>
<td>22.56%</td>
</tr>
<tr>
<td>Weighted Average, Direct Loans</td>
<td>16.71%</td>
</tr>
</tbody>
</table>

These projections are essentially unchanged from projections for the 2014 and 2015 cohorts.

Subsidy Rates for Direct Loans

- The budget breaks down Direct Loan subsidy rates by loan type and repayment plan. For 2016, the subsidy rates for new Direct Loans are projected to be as follows:
  - For Subsidized Stafford Loans, 4.33 percent;
  - For Unsubsidized Stafford Loans to undergraduates, -11.81 percent;
  - For Unsubsidized Stafford Loans to graduate/professional students, -24.86 percent;
  - For Parent PLUS Loans, -22.75 percent;
  - For Grad PLUS Loans, -38.03 percent; and
  - For Consolidation Loans, 17.10 percent.
- A positive number means there is a federal cost, while a negative number means the federal government makes money under Federal Credit Reform Act scoring. For example, the 4.33 percent subsidy rate for Subsidized Stafford Loans means the loan costs the federal government $0.433 for every $1.00 disbursed. These subsidy rates do not take into consideration administrative costs, which are 1.70 percent for all loans other than Consolidation Loans, and 1.45 percent for Consolidation Loans.
- Income-driven repayment (IDR) plans continue to be substantially more expensive to the federal government than other payment plans. For example:
  - The Stafford Loan subsidy rates for standard repayment is 3.16 percent;
  - The Stafford Loan subsidy rate for IDR plans are 14.48 percent;
  - The Unsubsidized Stafford Loan subsidy rates for standard repayment are -24.01; and
  - The Unsubsidized Stafford Loan subsidy rates for IDR plans are 13.84.
Each year, the budget includes a re-estimate and modifications to its prior subsidy cost estimates. This year, the budget increases the estimated costs for existing Direct Loans by $21.9 billion.

**Campus-Based Aid**

- The budget provides $733 million for Federal Supplemental Educational Opportunity Grants (SEOG), which would generate $976 million in aid for 1.6 million students (same as the FY 2015 enacted).
- The budget includes $990 million for Work-Study, which would generate $1.18 billion in aid to 703,000 students (same as FY 2015 enacted).
- The budget document mentions that allocations for SEOG and Work-Study would be reformed to target schools that enroll and graduate higher numbers of Pell-eligible students, and offer affordable and quality education and training such that graduates can obtain employment and repay their educational debt.
- As proposed in the last couple of budgets, the budget request calls for modernizing and expanding the Perkins Loan Program by turning it into a Direct Loan program under which the federal government, not schools, would originate and service the loans.
  - Loan volume would be allocated among degree-granting institutions according to a formula that would encourage schools to control costs and offer need-based aid to prevent excessive indebtedness, though schools would have some discretion over eligibility.
  - Loan terms would be the same as under the Unsubsidized Stafford Loan Program.
  - Beginning with the date provided in the Higher Education Act, and as existing Perkins loan are paid down, schools would retain their share and remit the remainder to the Department.
  - The Budget calls for $8.5 billion in the new Perkins Loans annually, beginning on July 1, 2016, and claims that subsidy cost savings of $418 million would result, which would be redirected to continue indexing the Pell Program to inflation.

**Student Aid Administration**

The budget includes $727 million for student aid administration and $855 million for student loan servicing activities, for a total of $1.582 billion. The amount is an increase of $185 million over the current fiscal year, the majority of which is due to additional expenses in servicing federally-held student loans.

**Tax Proposals**

- The budget proposes to consolidate the myriad of higher education tax benefits (see below), and expand and make permanent the American Opportunity Tax Credit (AOTC). Under the proposal, the maximum credit allowable under the AOTC would be indexed for inflation, the credit would be available for a fifth year of higher education, a partial credit would be provided for part-time students, and the refundable portion of the credit would also be increased.
• The budget would eliminate the tax on student loan debt forgiven under IDR plans.
• The budget eliminates the Lifetime Learning Credit, Coverdale Education Savings Accounts, the tuition and fees deduction, and the student loan interest deduction. While the budget document also calls for rolling back the subsidy on 529 savings plans, the Administration has already announced that it is withdrawing this proposal in face of bipartisan opposition (the budget was prepared prior to this development).
• The budget would create taxable America Fast Forward Bonds patterned after Build America Bonds and tax-exempt Qualified Public Infrastructure Bonds designed to help states and communities partner with the private sector for infrastructure investment projects.
• Other tax proposals include: tripling the Child and Dependent Care Tax Credit, expansion of the Earned Income Tax Credit, a second-earner tax credit where both spouses work, and automatic enrollment of workers without access to retirement plans into an Individual Retirement Account (IRA) through payroll deduction (with an option to opt-out).

Other Student Financial Aid Changes

• The budget proposes to reduce the number of questions on the Free Application for Federal Student Aid (FAFSA) through elimination of up to 30 questions regarding savings, investments, and net worth and continued use of the Internal Revenue Service (IRS) Data Retrieval Tool.
• The budget proposes to include revenue from other federal education programs (specifically, Department of Defense Tuition Assistance and GI Bill benefits from the Department of Veterans Affairs) received by for-profit schools in the calculation of the 90/10 rule. The 90/10 rule currently provides that at least 90 percent of the revenue of such schools must come from non-Title IV sources.

Changes to the Telephone Consumer Protection Act

• As proposed over the last few years, the budget clarifies that the use of automatic dialing systems and prerecorded messages is allowed when contacting wireless phones in the collection of federal debt. The proposal would allow the Federal Communications Commission (FCC) to implement rules to protect consumers from being harassed and contacted unreasonably.
• The proposal would result in $120 million in savings over 10 years. Of note, NCHER believes the savings from this proposal would be much higher.

Early Education and Elementary and Secondary School Education

• The budget maintains support for the Administration’s Preschool for All initiative. The increase in funds for the program are paid for from increases in federal tobacco taxes.
• The budget proposes a significant increase in funding for Head Start, also paid for from tobacco taxes.
• The budget proposes $26 billion for programs authorized under the Elementary and Secondary Education Act (ESEA), an increase of $2.7 billion or 11.8 percent over the current year. $1 billion of the increase is for grants under Title I of the ESEA, the grant program supporting low-income schools. There is also $3 billion in discretionary funding to provide support for teachers.