OPPAGA
OFFICE OF PROGRAM POLICY ANALYSIS
& GOVERNMENT ACCOUNTABILITY

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Office of Student Financial Assistance Improved Some Functions, But Additional Changes Would Enhance Services

at a glance

OSFA's services continue to benefit the state, and the office has implemented some of the recommendations made by our 2003 review. However, the office would benefit from additional changes to its performance measures, loan default prevention program, and organizational structure and placement. Specifically,

- OSFA needs to address federal policy changes and competition that have inhibited its revenue growth;
- while OSFA has improved its performance measures, additional changes are needed to better report its outcomes to the Legislature;
- OSFA continues to have one of the nation's highest default rates on student loans; however, in July 2004 it began to enhance its default prevention plan; and
- changes in OSFA's organizational structure would enhance its effectiveness as a student loan guaranty agency.

Scope

In accordance with state law, this progress report informs the Legislature of the extent to which the Department of Education has addressed the recommendations made in a 2003 OPPAGA report. [1, 2]

Background

The Office of Student Financial Assistance (OSFA) is located within the Department of Education under the direction of the agency's chief financial officer. The office is responsible for two major program areas: managing state scholarship and grant programs and administering the federal student loan program. As shown in Exhibit 1, OSFA administered over 477,000 student loans and grants in Fiscal Year 2003-04, with a value of over $1.8 billion.

Exhibit 1
OSFA Administered Nearly $2 Billion in Scholarships, Grants, and Loans in 2003-04

	Awards/Loans	Volume
State Programs	255,931	$414 Million
Federal Programs	221,431	1.4 Billion
Total	477,362	$1.8 Billion

Source: *Office of Student Financial Assistance 2003-04 Annual Report.*

OSFA performs a variety of student financial aid services. Depending on the requirements of the individual programs it administers, OSFA's responsibilities include originating student loans, providing customer service to borrowers, working with students to avoid loan defaults, and recovering unpaid loan payments. While the office provides most of these services with in-house staff, it has contracted with private vendors for certain default aversion and recovery services. The office currently has 199 full-time equivalent employees, of which 48 administer state programs and 151 administer federal student financial aid programs. OSFA's services are funded by

[1] Section 11.51(6), *F.S.*

[2] *Office of Student Financial Assistance Generally Performs Well, but Performance Measurement and Default Prevention Should be Improved,* OPPAGA Report No. 03-16, February 2003.

$330.2 million in state appropriations from general revenue and state trust funds and $26.7 million in appropriations from earnings relating to the administration of the Federal Family Education Loan Program.

Previous Findings

Our 2003 report concluded that OSFA performed fairly well but faced challenges and could take steps to improve its operation and value to the state.

We concluded that OSFA benefits the state by administering student aid programs that ease the financial burden of college attendance, and its administration of the federal student loan program generates revenue that can be used to support state financial aid initiatives. OSFA's guaranteed student loan volume and the percentage of defaulted loans it recovered had risen markedly in recent years, and its reserve fund ratio was well above the minimum federal threshold. In addition, OSFA's key stakeholders expressed a high level of satisfaction with its services.

However, OSFA needed to improve its performance in preventing students from defaulting on their loans. In 2000, OSFA had the highest cohort loan default rate (9.1%) in the nation, which could affect its long-term ability to pay lender claims if the balance in its Federal Student Loan Reserve Fund fell below a specified level due to the high payouts for defaults. We recommended that the office take immediate steps to implement a default prevention plan that it had developed but not fully implemented.

Our 2003 report also noted that OSFA needed to improve its legislative measures. OSFA had reported misleading information for some of its measures and lacked data needed for other measures. We also recommended that the Legislature consider adding performance measures assessing college affordability and the office's performance in administering financial aid programs.

Finally, we noted that changes to OSFA's organizational structure to exempt it from certain administrative requirements or establish it as an entrepreneurial non-state entity could enhance its operations and generate additional revenue to support state financial aid initiatives.

Current Status

OSFA's services have continued to benefit the state, and the office has implemented some recommendations from our 2003 report. However, changes to OSFA's performance measures, loan default prevention program, and organizational structure and placement would improve its operations.

OSFA continues to assist students and generate revenue, but federal policy changes and competition will reduce its revenues

In the last two fiscal years, the number of students to whom OSFA awarded state financial aid has increased. In 2003-04, OSFA awarded 255,931 scholarships and grants, an increase of 3.5% over the previous year. OSFA continues to generate significant revenue through its federal loan administration activities. A portion of these funds is used to support other state financial assistance programs. In 2003, the guaranty function yielded $9.84 million in net earnings.

However, two factors will likely reduce OSFA's future earnings: (1) changes in federal loan program policy and (2) increased competition from other loan guaranty agencies.

Changes in the federal loan processing fee reduced OSFA profit margin. The Federal Family Education Loan Program provides an incentive for guaranty agencies to expand loan volume. Beginning October 2003, federal legislation lowered the loan processing and issuance fee from 0.65% to 0.40% of disbursed loan volume. Under the new rate, OSFA would have earned $3.27 million from the $504 million loan volume in 2003-04, compared to $2.24 million under the old rate, resulting in $1.03 million less revenue in that year.

Two Florida postsecondary institutions switched to competing guaranty agencies. In addition, OSFA has lost the loan guarantee business of two of Florida's public universities. In 2003, both Florida State University and Florida Atlantic University switched from using OSFA as their loan guaranty agency to a private nonprofit guaranty agency. [3] This shifted 22% ($144.4 million in loan volume) of

[3] Although students may choose any guaranty agency for their loans, an institution's preferred provider is generally the students' default choice.

the Florida public institution market from OSFA to its private competitors, thus reducing the revenue available to support state student financial aid programs. [4]

OSFA has improved some performance measures, but additional changes are needed

The department has taken steps to improve its legislatively mandated performance measures. However, additional steps would further improve its accountability system.

OSFA has collected data needed to accurately report on two performance measures—the percentage of high school graduates completing core high school credits and the percentage attending college in Florida. However, the office has not yet collected and reported data for the three legislative performance measures shown in Exhibit 2. We continue to recommend that OSFA collect and report data for these measures.

Exhibit 2
OSFA Still Does Not Report Data for Three Legislative Performance Measures

Measure	Reason for Not Reporting
Award recipient retention rates	OSFA chose to use 1999-00 as the baseline year for these data and only recently (September 2004) collected the data necessary to calculate four-year rates. The office has not yet analyzed the data and must wait until fall 2006 to report six-year retention rates.
Award recipient graduation rates	OSFA acknowledged the need to match its recipient data to other data collected by DOE from universities and community colleges. However, the office has thus far only explored available data.
Critical shortage areas	The Critical Teacher Shortage Forgivable Loan Program last received appropriations in Fiscal Year 2001-02. Thus, the most recent cohort of college students who received program benefits began entering the workforce in the 2002-03 and 2003-04 academic years.

Source: Office of Student Financial Assistance.

The Legislature has not yet required OSFA to report on other aspects of its performance. We continue to believe that adding five measures would enhance the Legislature's ability to evaluate OSFA's performance and financial aid policies.

- Customer satisfaction (borrowers, lenders, and institutional financial aid personnel)
- Total number and amount of loans annually guaranteed
- Annual percentage of loans recovered or collected (as a percentage of total loans in default)
- Federally calculated cohort default rate for student loans
- Unmet student financial need as a percentage of the cost of attendance

The office already collects data for three of these proposed measures. [5]

Loan defaults remain high, but OSFA has begun to implement its default prevention plan

As shown in Exhibit 3, OSFA's loan default rate has improved slightly, but it remains the second highest of the nation's 36 guaranty agencies. [6] We found in our previous report that the office had focused more on providing default aversion services (which begins once a borrower is already delinquent) than on default prevention services, which help all borrowers to avoid default whether delinquent or not. However, OSFA has since increased its default prevention activities.

Exhibit 3
OSFA Default Rate on Guaranteed Student Loans Remains High

	2001 Default Rate	2002 Default Rate
OSFA	9.2%	8.9%[1]
Florida	7.1%	7.0%
National	5.4%	5.2%

[1] OSFA is appealing the federal calculation, reporting it as 8.6%.

Source: U.S. Department of Education.

Although both federal rules and long-term business strategy require substantial efforts be made to avoid loan defaults, a high default rate increases the office's revenue through reimbursements from the federal government, as OSFA pays 1% penalty for defaulted loan principal and interest to the federal government but can earn 23% of the amount recovered on the defaulted loan. As shown in Exhibit 4, OSFA earned $14,360,376 net of expenses as a result of

[4] OSFA recovered considerable loan volume by increasing its consolidated loan guaranty volume.

[5] The office collects data for loans guaranteed, loans recovered and defaulted, and federally calculated default rates.

[6] Statewide and national comparisons may be limited because default rate may be affected by the demographic makeup of borrowers in different institutions and by economic conditions. However, the national average is the performance benchmark for OSFA's recently contracted default prevention services, so the difference between Florida and the rest of the country is relevant.

the federal reimbursement formula from defaulted student loans in Fiscal Year 2002-03.

Exhibit 4
OSFA Earned $14.3 Million from Student Loan Defaults in Fiscal Year 2002-03

Recoveries of Reinsured Loans	$15,183,554
Default Aversion Fees	4,184,416
Commissions to Contractors	(4,040,012)
Fee to Federal Government	(967,582)
Net Revenue from Defaults	**$14,360,376**

Source: OPPAGA analysis of Office of Student Financial Assistance financial statements.

The office's successful recovery of defaulted loans fell from 24% in 2001 to 18% in 2003. However, in part this was due to a modification of OSFA's market recovery strategy that should increase long-term earnings but caused a short-term drop. It was also due to the fact that recoveries in 2001 were substantially higher than prior years because OSFA contracted with outside entities to recover defaulted loans; as this activity matured the recovery rate stabilized at a lower level. Since OSFA receives 23% of the value of each defaulted loan recovered, the reduction in loan recoveries resulted in lower earnings.

To address its high default rate, OSFA has taken steps to implement its default prevention program. In 2002 OSFA hired a default prevention manager and began default prevention training for financial aid staff, and in July 2004 the office entered into a three-year contract for default prevention services. During the first contract year, the contractor will train lenders and develop electronic resources (e.g., website, multi-media presentations) to support the default prevention program. Nearly 50% of the $2.6 million contract is to be spent on these resources. During the second and third contract years, the contractor will further develop electronic resources and will survey and train borrowers, lenders and institutional financial aid staff. The contractor also will score OSFA's guaranteed portfolio to identify at-risk borrowers.

If the contractor is able to reduce OSFA's cohort default rate below the national average, it will be rewarded with a 10% bonus of approximately $259,000. If it fails to meet this benchmark, the contractor will be penalized by this amount. However, since most of the contracted training activities will not begin until the contract's second year and since students borrowing now generally will not experience the benefits of default prevention activities for several years, little immediate change in OSFA's default rate will likely occur as a result of this default prevention contract.

The Legislature should consider organizational changes to enhance OSFA's effectiveness as a guaranty agency

Restructuring OSFA's guaranty agency function as an entrepreneurial enterprise would enhance the office's competitiveness and effectiveness. This would help address the increased competition facing the office, and improve its ability to generate funds that the Legislature can use to support state financial aid programs.

As discussed in our prior report, two options for legislative consideration are (1) statutorily exempting OSFA from certain governmental administrative and structural requirements to provide it more flexibility in personnel, procurement, and marketing; and (2) abolishing OSFA and recreating its functions as a nonprofit auxiliary or direct support organization of the Florida Board of Education. Either option would improve the program's ability innovate and compete with guaranty agencies that already operate as private or nonprofit organizations. We continue to recommend that the Legislature consider organizational options for OSFA's guaranty agency function.

OPPAGA supports the Florida Legislature by providing evaluative research and objective analyses to promote government accountability and the efficient and effective use of public resources. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021 or 800/531-2477), by FAX (850/487-3804), in person, or by mail (OPPAGA Report Production, Claude Pepper Building, Room 312, 111 W. Madison St., Tallahassee, FL 32399-1475). Cover photo by Mark Foley.

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