American Enterprise Institute

THE PARTHENON GROUP
Boston • London • Mumbai • San Francisco

Student Value Proposition Discussion

October 5th, 2010

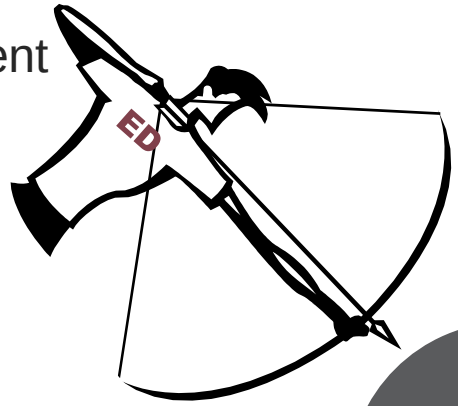
Agenda

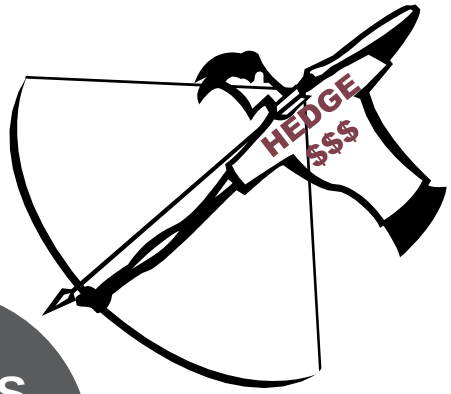
For-Profit Post-Secondary Value Proposition

Impact of Proposed Gainful Employment Regulation

For-profit education is under attack from all sides!

- CDR
- Gainful employment
- Incentive compensation





$26B U.S. For-profit PSE

- "Sub-prime goes to college"
- The next big short

- Public sector competence
- Commoditization of online

Intense legislative, regulatory, political, and press scrutiny shows no sign of ending…

"Analysis: For-profit Colleges Haul in Federal Aid"

– USA Today (November 30, 2009)

"Student Loan Defaults Rack Up in Pennsylvania

Students at for-profit schools in Pennsylvania defaulted nearly three times more often on federally guaranteed loans than students at traditional colleges and universities"

– Pittsburgh Tribune Review (January 31, 2010)

"For-profit Colleges Spur Dreams and Doubts –

Critics wonder if popular schools are a good deal for students and taxpayers"

– Pittsburgh Tribune Review (January 31, 2010)

The American Graduation Initiative

President Barack Obama called for an additional 5 million community college degrees and certificates by 2020… Together, these steps will cost $12 billion over the next decade

– President Obama (July 14, 2009)

…and Washington seems focused on tighter regulations centered on assuring quality outcomes

"As For-profit Colleges Flourish, Focus Turns to Grads' Success and Debt" – *Denver Post (January 17, 2010)*

"Leveraging Up To Learn" – *Barron's (November 9, 2009)*

"Rules May Tighten in Regulating For-profit Colleges" – *Denver Post (January 18, 2010)*

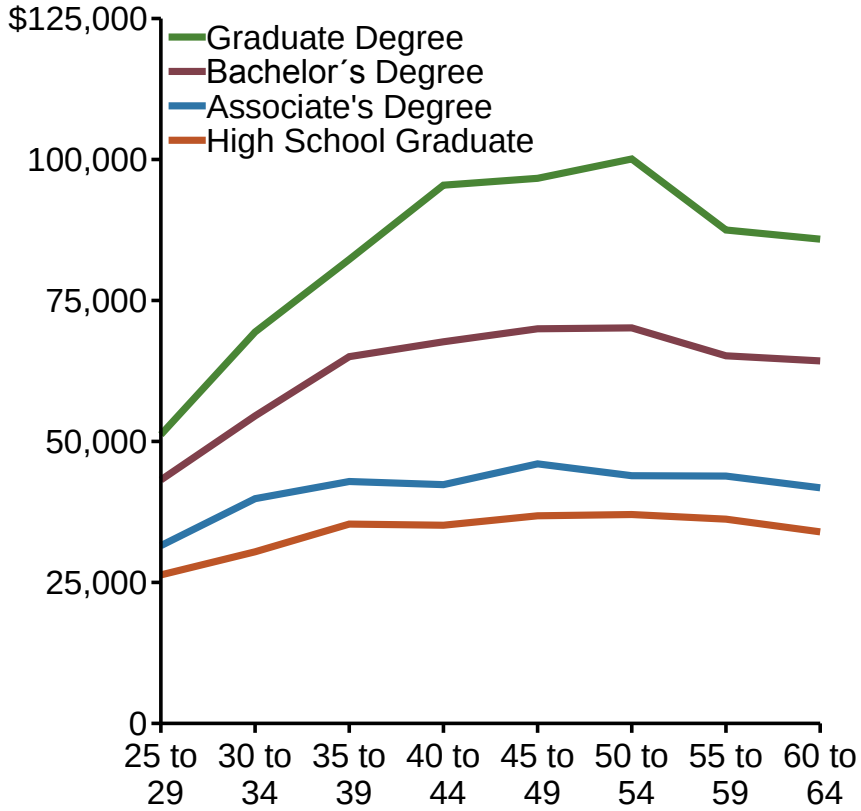
"Shares of U.S. Education Companies Fall on Regulation Concerns" – *Reuters (January 28, 2010)*

"Education Stocks Continue Slide on Gainful Employment Fears" – *Wall Street Journal (January 29, 2010)*

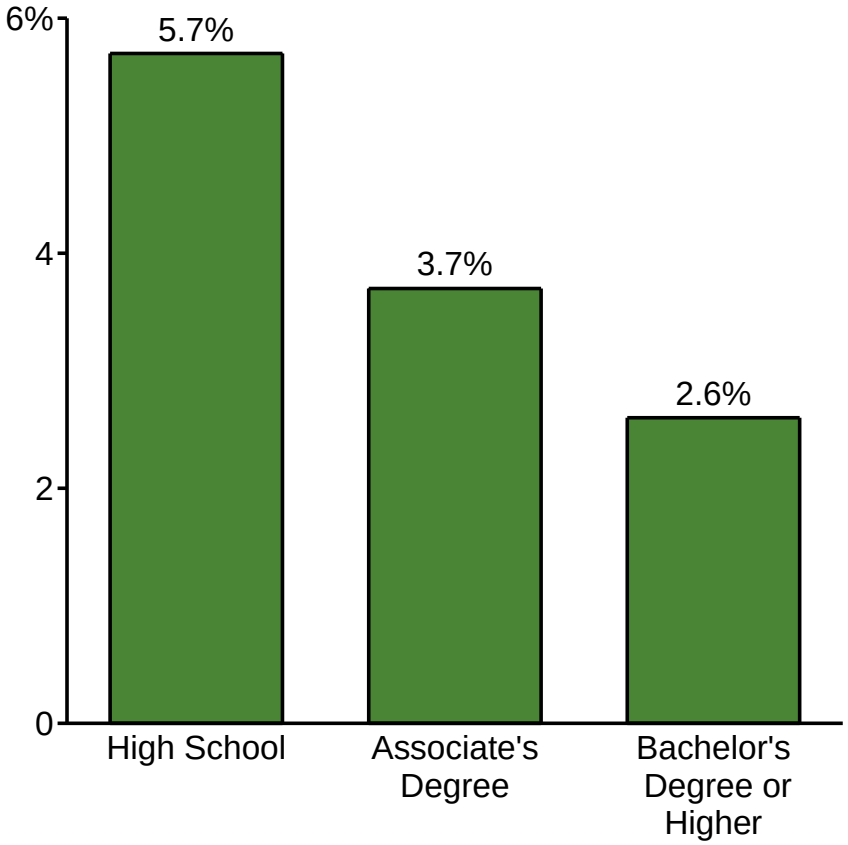
Underlying all of these attacks appears to be a belief that for-profit education providers are likely to suppress investments in educational quality and student outcomes in favor of profits

Post-secondary education yields higher earnings and lower unemployment rates

Median Annual Salary by Age Group and Degree Type, 2008



Rate of Unemployment by Education Level, 2008



Source: U.S. Census Bureau

We are failing to educate our citizens, and this challenge is more acute with non-traditional students

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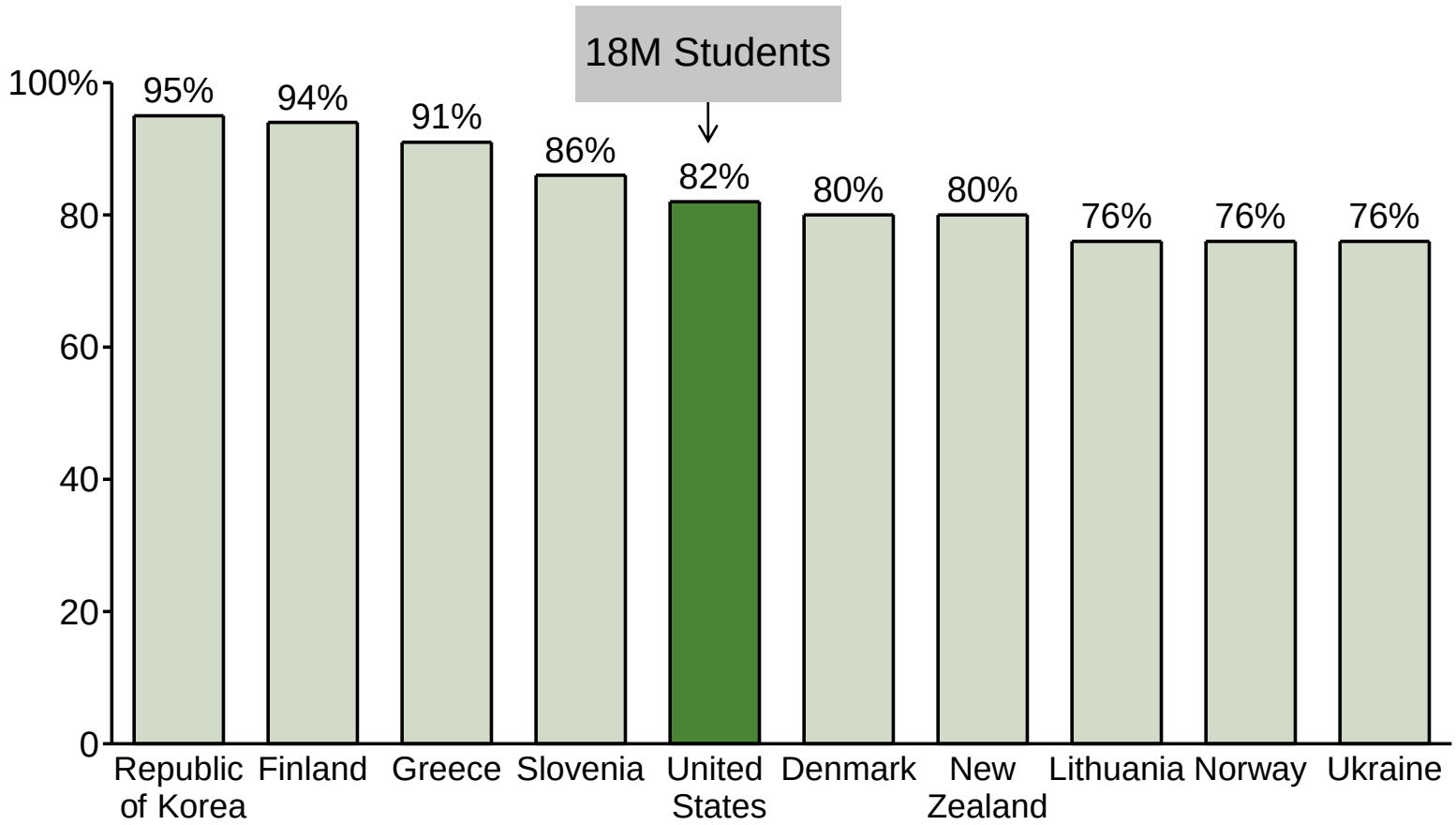
Top 10 Post-Secondary Enrollment Ratios Worldwide, 2007

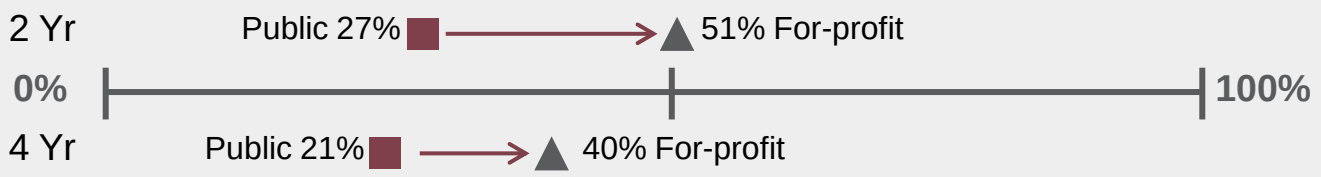


Source: BMO Capital Report (2009); UNESCO; World Bank

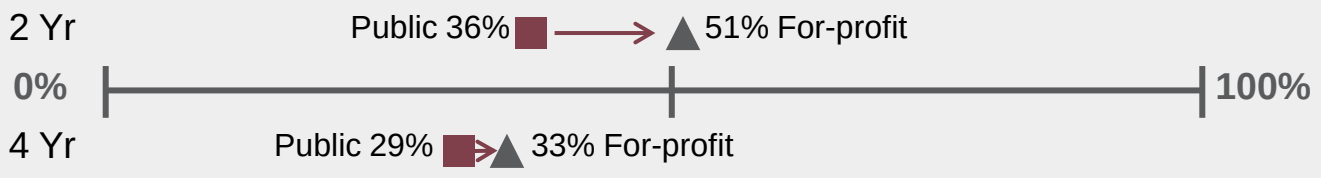
For-profit institutions are successfully addressing latent demand…

■ = Public
▲ = For-profit

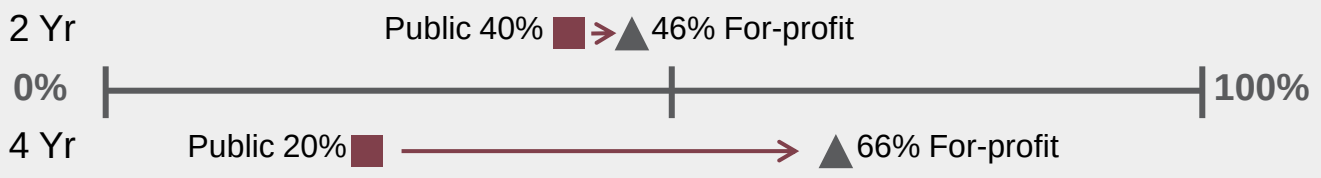
Enrollment of Low Income Students by Institution Type, 2008



Enrollment of Non-White Students by Institution Type, 2007



Enrollment of Students Age 25 and Over by Institution Type, 2007

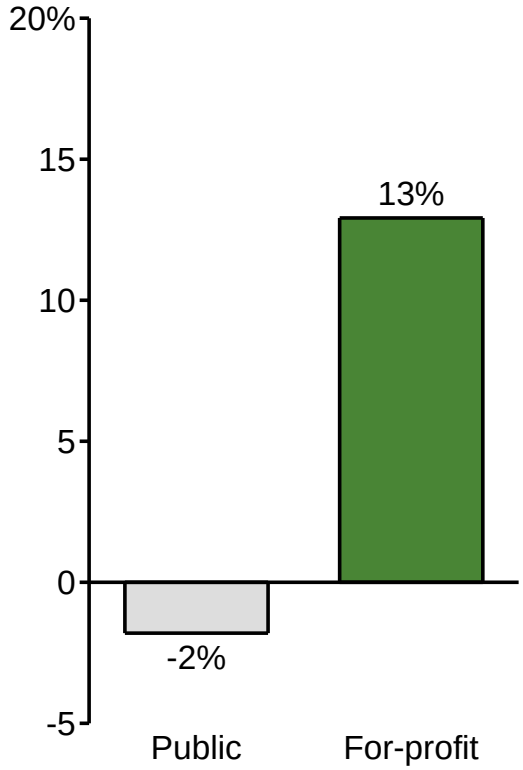


Note: "2-Year" category includes 2-year and less-than-2-year institutions; an independent student's income or the income of a dependent student's parents is considered "Low Income" if it falls within the lowest quintile of U.S. household income; the upper limit of the lowest quintile was $20,712 in 2008

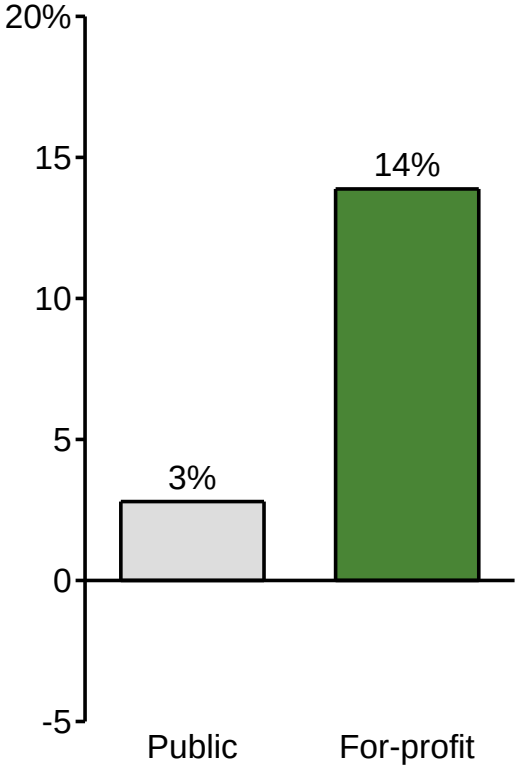
Source: NCES IPEDS database; NCES NPSAS 2008

…And driving expanded access to higher education among underrepresented populations

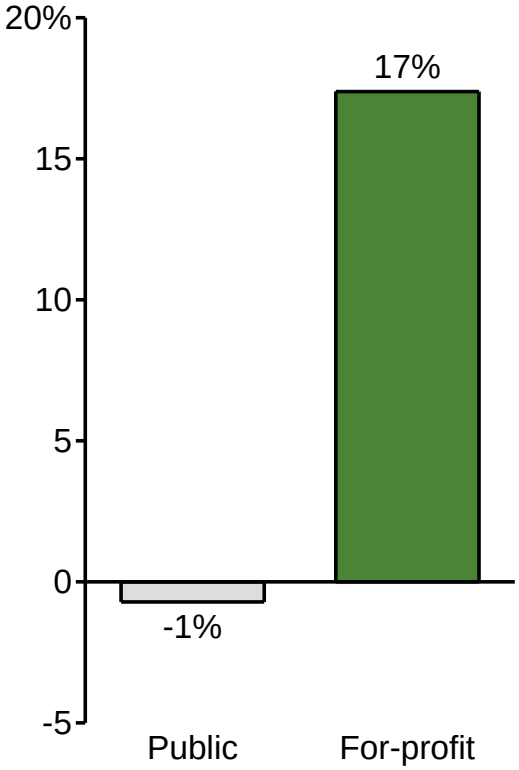
Low-Income Student Enrollment Growth, 2004-08



Non-White Student Enrollment Growth, 2003-07



Age 25 and Over Student Enrollment Growth, 2003-07

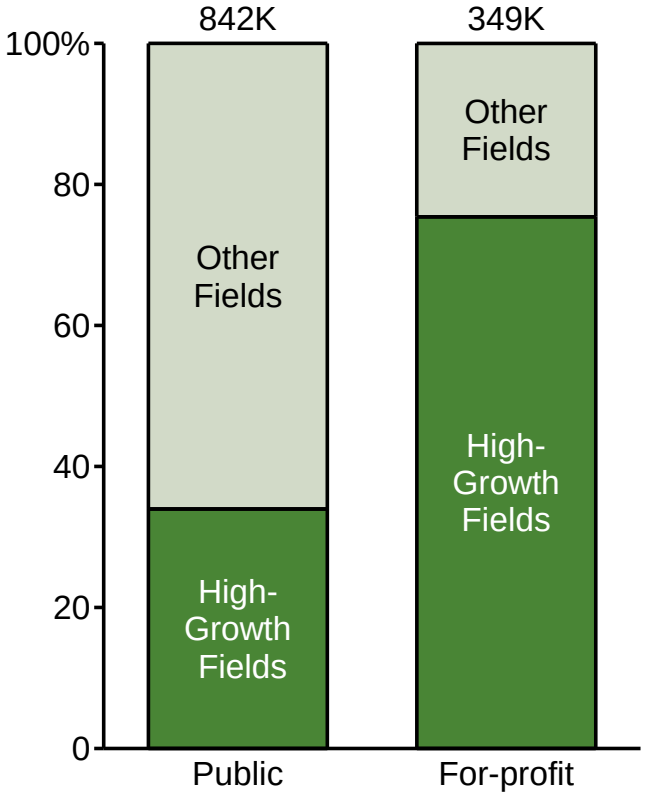


Note: An independent student's income or the income of a dependent student's parents is considered "Low Income" if it falls within the lowest quintile of U.S. household income; the upper limit of the lowest quintile was $18,500 in 2004 and $20,712 in 2008

Source: NCES IPEDS database; NCES NPSAS 2004 and 2008; Census Bureau

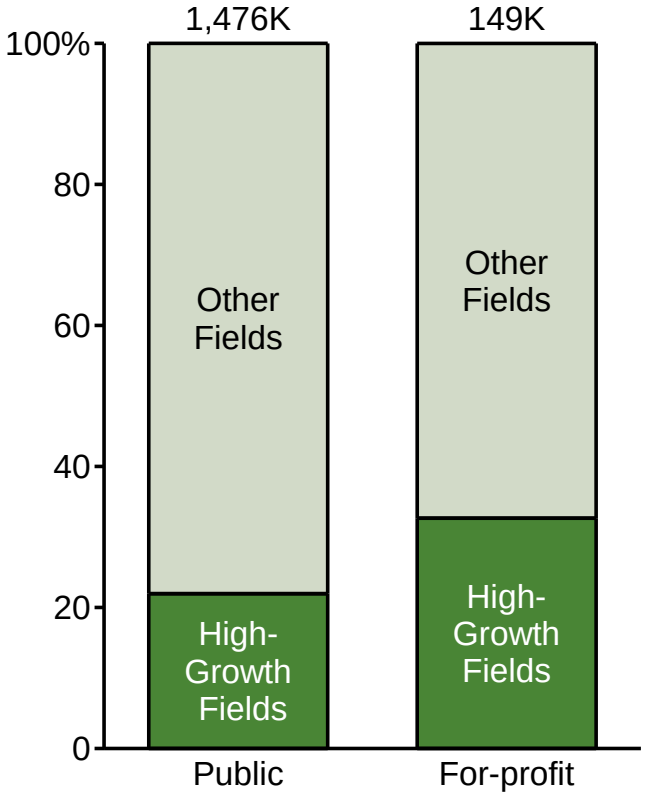
For-profit graduates are prepared for job fields with greater employment needs

Degrees/Certificates/Diplomas Conferred by Field of Study, 2-Year Institutions, 2008



	Public	For-profit
% High Growth	34%	75%

Degrees Conferred by Field of Study, 4-Year Institutions, 2008



	Public	For-profit
% High Growth	22%	33%

High-growth fields, 2008-2018E (avg. growth rate: 1.9%)

- Computer and IT Services
- Public Administration
- Health Professions
- Physical Sciences
- Personal and Culinary Services
- Mathematics
- Biological Sciences

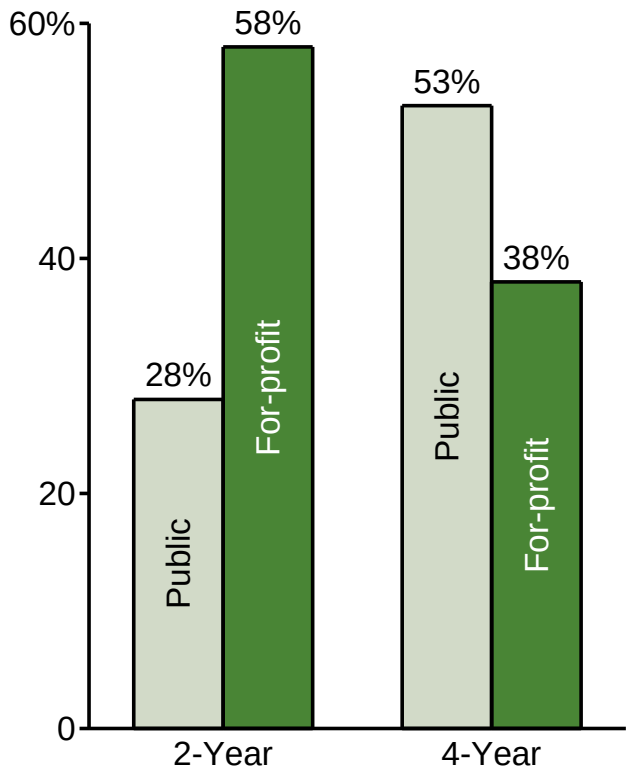
Low-growth fields, 2008-2018E (avg. growth rate: 0.7%)

- Agriculture
- Construction
- Theology
- Architecture

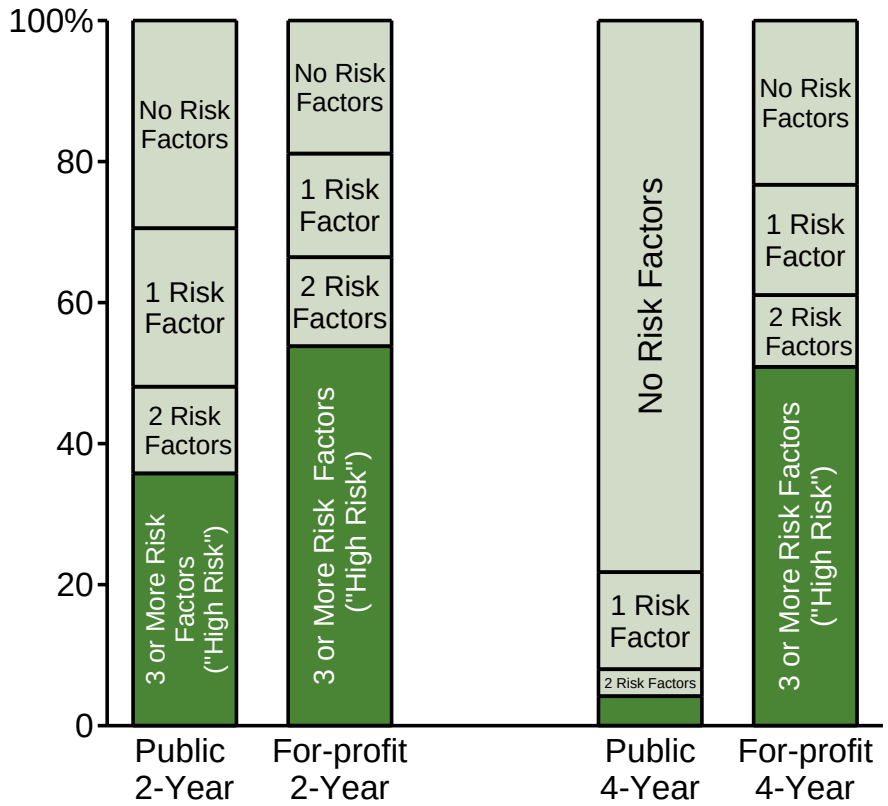
Source: NCES IPEDS database; BLS

For-profits deliver strong graduation rates despite higher student persistence risk

Completion Rate at 2-Year (2001) and 4-Year (2008) Institutions



Persistence Risk at 2- and 4-Year Institutions, 2004



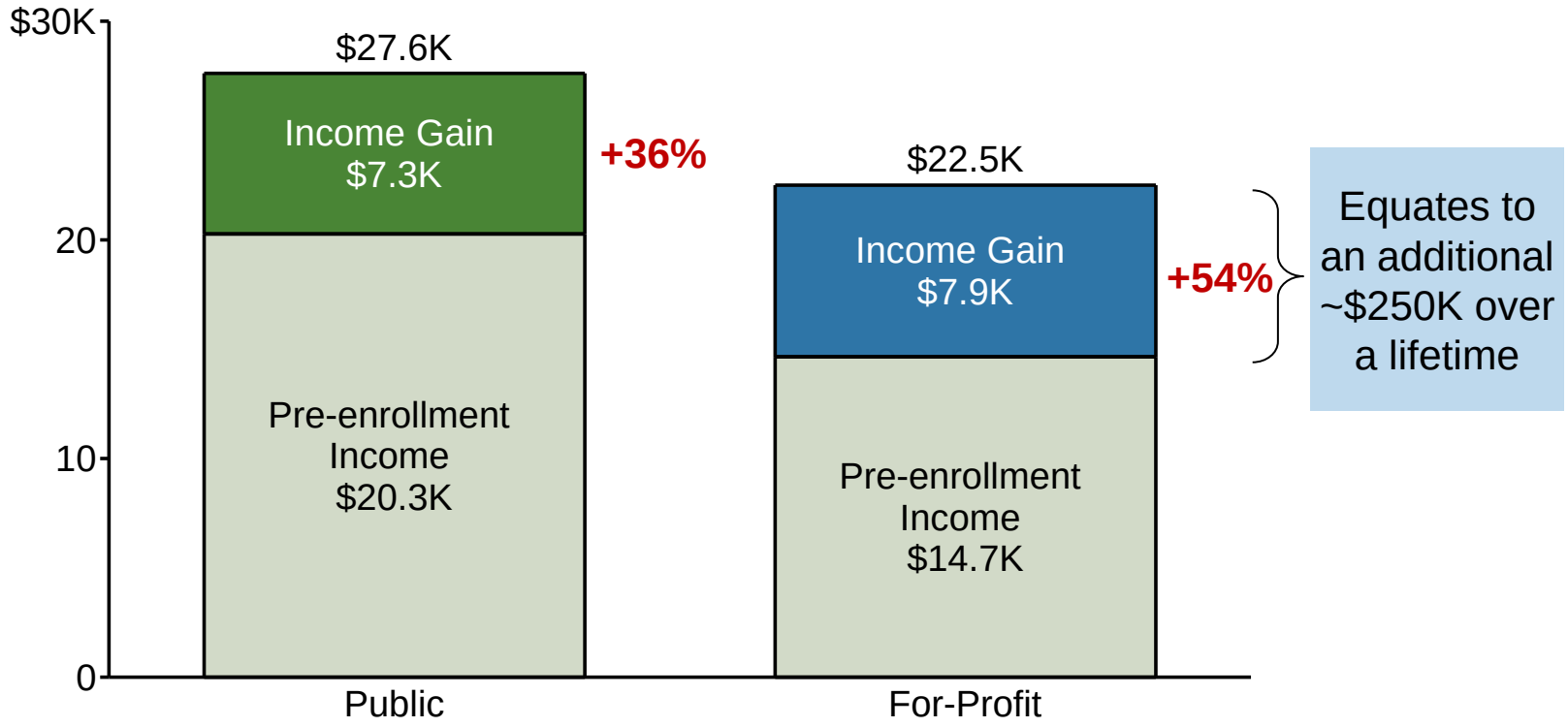
	Public 2-Year	For-profit 2-Year	Public 4-Year	For-profit 4-Year
% "High Risk"	36%	54%	4%	51%

Note: Completion rates are calculated 5 years post-enrollment for 2-year institutions and 6 years post-enrollment for 4-year institutions, and exclude transfers; "2-Year" category includes 2-year and less-than-2-year institutions; "high risk" defined as 3 or more of the following factors: Delayed enrollment, No high school diploma, Part-time enrollment, Financially independent, Have dependents, Single parent status, Working-full time while enrolled

Source: NCES BPS 1996-2001; NCES BPS 2004-2006; NCES IPEDS database

Both for-profit and public university students have strong income gains that propel students into viable careers

Dollar Gain in Annual Income, 2-Year and Less Institutions, 2002-2005



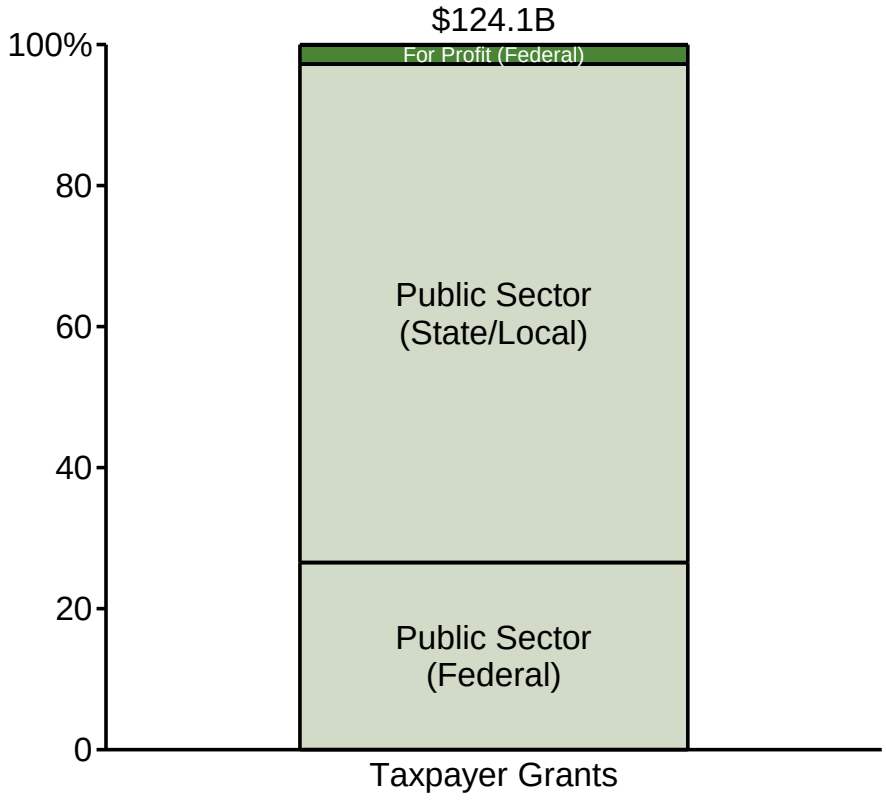
	Public	For-Profit
Return on Investment*	8.7X	8.8X

Note: *Return on Investment = Incremental lifetime earnings estimate/average cost per completion; includes independent students not enrolled as of 2005 who did not transfer; Lifetime earnings estimate = Annual income gain * 30 years employment

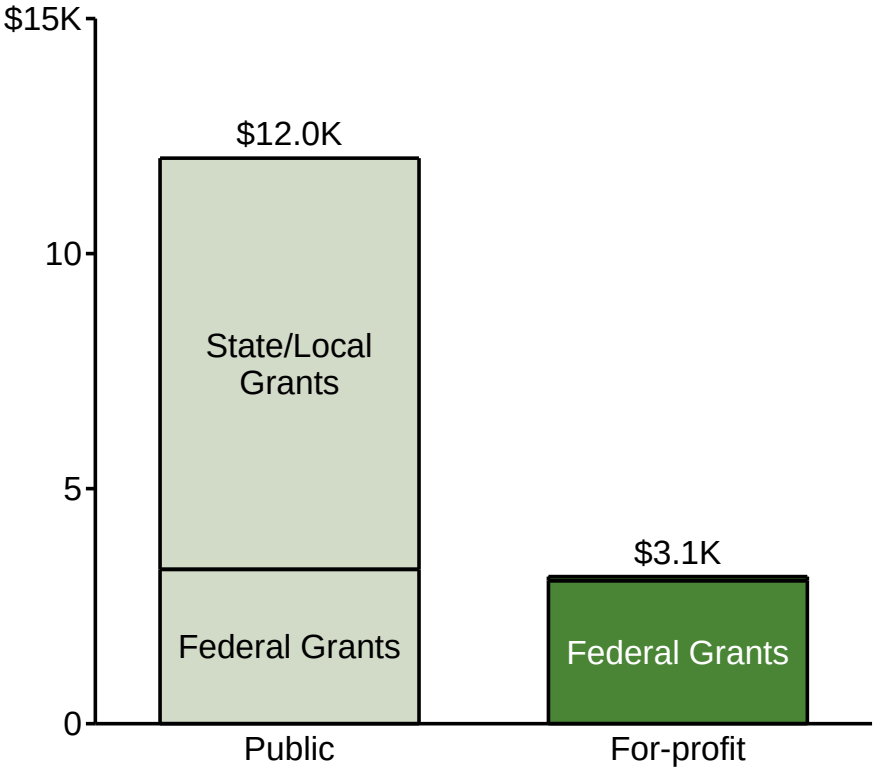
Source: NCES BPS 2004-2006

Yet for-profits lack equal access to public funding…

Share of State, Local and Federal Grants by Institution Type, 2007



Taxpayer Grants Per FTE, 2007



Note: Federal and state/local grants include grants, contracts, and tax revenue
Source: NCES IPEDS database

…leading to predictably higher tuition levels; yet, the total cost per FTE or per positive outcome is similar

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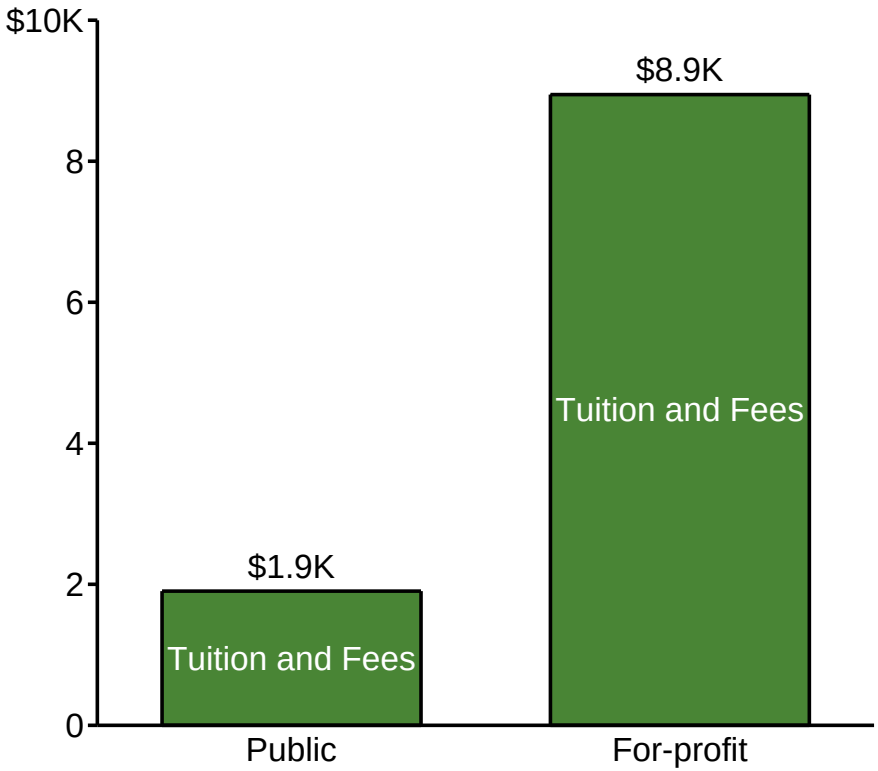
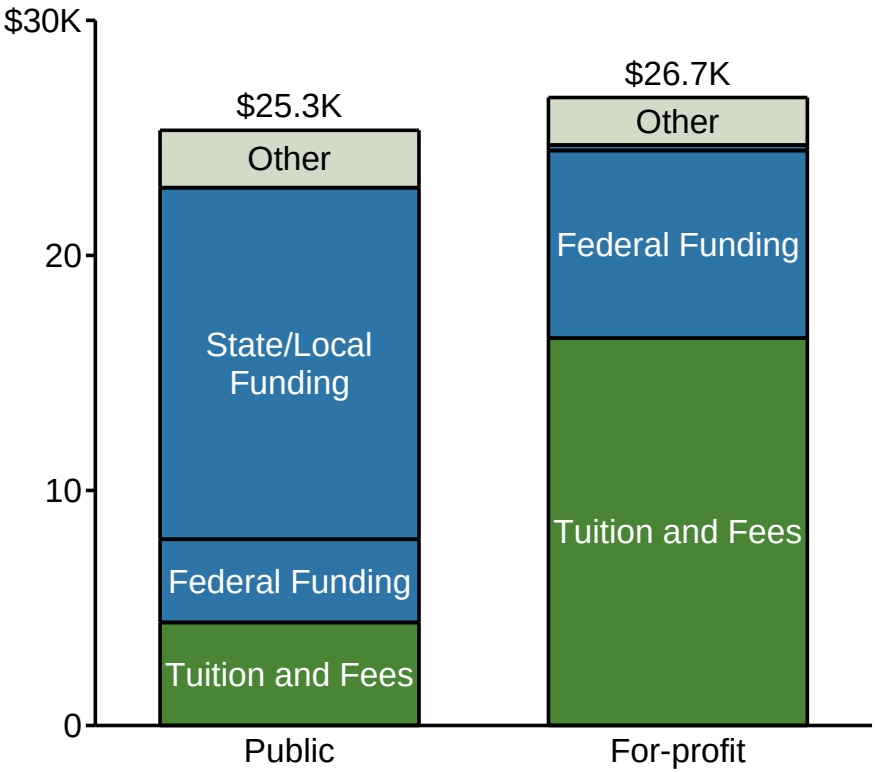
Average Tuition and Fees per FTE, 2-Year Institutions, 2007



Cost Per Positive Outcome, 2-Year Institutions, 2007



Note: Federal and state/local grants include grants, contracts, and tax revenue; data includes 2-year and less-than-2-year institutions; positive outcomes; includes transfer students

Source: NCES IPEDS database; NCES BPS 1996-2001

Though anomalies exist, median student debt levels are manageable

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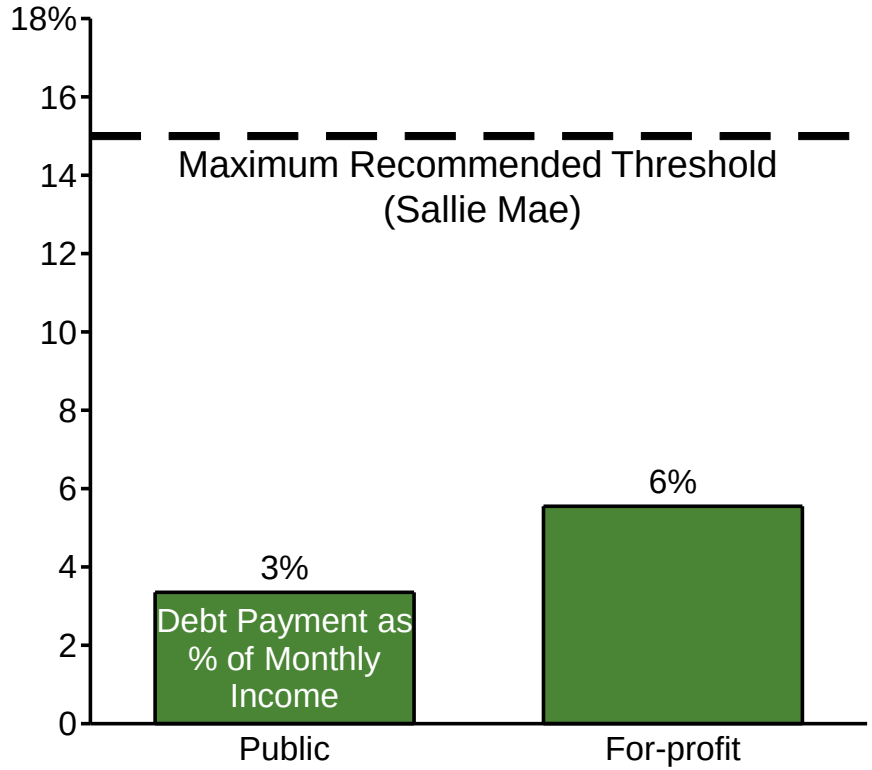
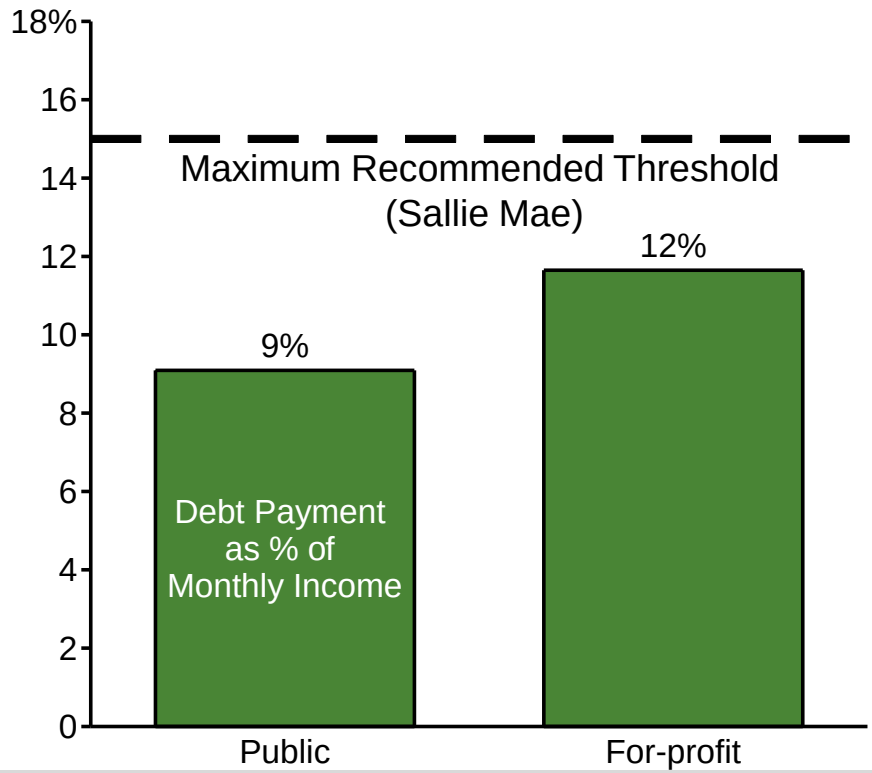
Graduate's Average Monthly Student Loan Payments, 2-Year Institutions, 2008



	Public	For-profit
Median Loans	$7,728	$10,125

Graduate's Average Monthly Student Loan Payments, 4-Year Institutions, 2008



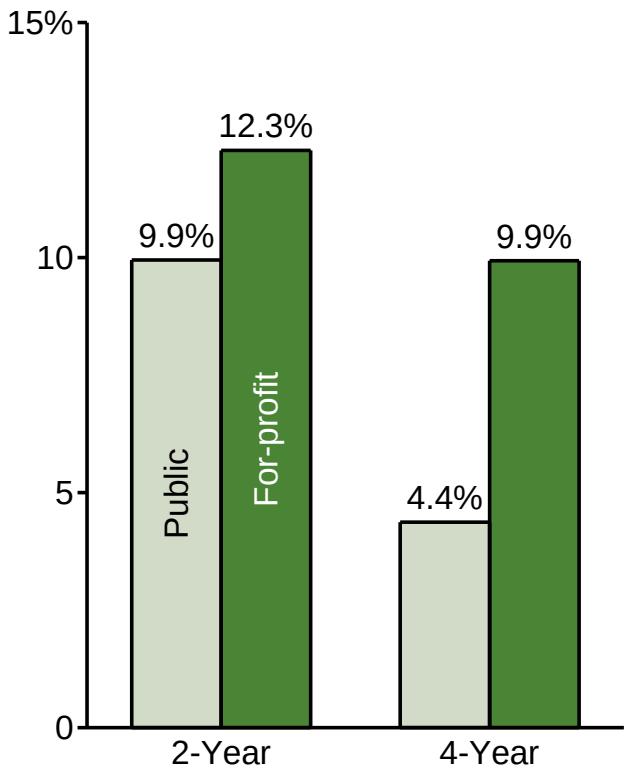
	Public	For-profit
Median Loans	$17,125	$24,125

Note: Debt burden calculated on a 10-year repayment at 6% fixed interest rate; includes all financial aid; income based on 2005 BPS figures and adjusted using BLS wage rate increases; "2-Year" category includes 2-year and less-than-2-year institutions

Source: U.S. Department of Education, NCES IPEDS database; NCES NPSAS 2007–2008; NCES BPS 2004-2006; BLS; FinAid; Sallie Mae

For-profit default rates are higher but default is driven by borrower characteristics, not institution type

2-Year Cohort Default Rates by Institution Type, 2007 Cohort



"Factors Affecting the Probability of Default: Student Loans in California"
NASFAA Journal of Student Financial Aid, Jennie Woo, 2002

- Race
- Family income
- Lack of high-school diploma
- Did not attain post-secondary degree
- Unemployed
- School type (2-year schools have higher default rates)

"Factors Associated with Student Loan Default Among Different Racial and Ethnic Groups"
Journal of Higher Education, J. Fredericks Volkwein, et al, 1998

- Gender
- Family income
- Lack of high-school diploma
- Low parent education
- Did not attain post-secondary degree
- Have dependent children
- Single
- School type (2-year schools have higher default rates)

Note: "2-Year" category includes 2-year and less-than-2-year institutions
Source: U.S. Department of Education

Agenda

For-profit Post-Secondary Value Proposition

Impact of Proposed Gainful Employment Regulation

Despite the for-profit's strong value proposition, ED proposed 'gainful employment' regulation that specifically targets the sector

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		Debt Burden		
		Above 12% of Earnings AND Above 30% of Discretionary Income	Between 8% and 12% of Earnings OR Between 20% and 30% of Discretionary Income	Below 8% of Earnings OR Below 20% of Discretionary Income
Repayment Rate	Above 45%	Eligible for Title IV Funds Must warn prospective and current students of high debt levels and disclose most recent debt measures for the program	Eligible for Title IV Funds Must warn prospective and current students of high debt levels and disclose most recent debt measures for the program	Eligible for Title IV Funds No disclosure requirements
	Between 35% and 45%	Restricted Title IV Funds Use: Institutions must: 1. Demonstrate employer support for the program 2. Warn prospective and current students of high debt levels and provide the most recent debt measures for the program 3. Limits enrollments in the program	Restricted Title IV Funds Use: Institutions must: 1. Demonstrate employer support for the program 2. Warn prospective and current students of high debt levels and provide the most recent debt measures for the program 3. Limits enrollments in the program	Eligible for Title IV Funds Must warn prospective and current students of high debt levels and disclose most recent debt measures for the program
	Below 35%	Ineligible for Title IV Funds: 1. No new students may receive Title IV aid 2. Current students may continue to receive aid for the rest of the year and one additional year 3. While phasing out the program, the institution must warn current and prospective students of high debt loads and reduced ability to repay their loans	Restricted Title IV Funds Use: Institutions must: 1. Demonstrate employer support for the program 2. Warn prospective and current students of high debt levels and provide the most recent debt measures for the program 3. Limits enrollments in the program	Eligible for Title IV Funds Must warn prospective and current students of high debt levels and disclose most recent debt measures for the program

Source: U.S. Department of Education NPRM

ED relied on a dataset in Missouri with missing information and then applied these estimates to the entire country

Proposed Regulation

- ED's proposed "gainful employment" (GE) regulations represent an effort to ensure that students attend quality programs and that both students and taxpayers receive good value for their joint investment in post-secondary education
- Specifically, all programs serving for-profit students and all certificate programs at not-for profit schools will be subject to the proposed regulation which is based on two tests:
  - The principal repayment rate for graduating cohorts
  - A debt burden test measured as either the graduating cohort's debt-to-income or debt-to-disposable-income ratio

Initial Analytical Approach

- ED evaluated the impact on student access through an analysis of 769 programs covering roughly 50,000 students in Missouri
- Calculating debt to income tests and repayment tests on these programs allowed ED to extrapolate the national impact

Potential Biases in the Missouri Data that Should be Accounted For

- The Parthenon Group's analysis of the Missouri data sets, made available by ED, indicates that several analytical adjustments should be considered to fully estimate the impact of the proposed regulation on student access:
  - Incorporating private student loan balances (which were excluded in ED's analysis) as they are part of the proposed debt to income test
  - Incorporating income estimates of students with no income (who were excluded from the Missouri income averages) as they are likely to be under or unemployed
  - Making adjustments when extrapolating to a national impact estimate as Missouri is not representative of national demographics, tuition levels or income levels
  - Updating the Missouri data to account for changes in the broader economy since 2008

Revising the methodology to fully reflect private loans, unemployed students, and sample bias raises the impact substantially

The potential impact and unintended consequences are far greater than ED estimates

How Many Students are Likely to be in Ineligible Programs?

- The Parthenon Group's comment in no way challenges these admirable policy goals; however, our analysis indicates that the regulations, as proposed, may accidentally frustrate these policy goals
- When analytical adjustments are made, the proposed Gainful Employment regulation is likely to impact approximately 1,000,000 students who would have enrolled in programs likely to become ineligible for Title IV funding

What is the Potential Impact on Student Access?

- The Parthenon Group's assessment of the ability, or willingness, for students to choose other programs concludes that post-secondary access will be significantly impacted as:
  - Many of the affected programs are not common outside of for-profit education institutions (e.g., Medical Assisting, Cosmetology)
  - Students are unlikely to choose degree programs outside of their initial degree duration (e.g., 4-yr programs vs. 2-yr programs)
  - Programs not impacted by the proposed regulations are not physically proximate to impacted programs and student commute times are a real barriers
- While ED estimated that approximately 90% of students will choose another program, The Parthenon Group's analyses indicate that this may be closer to only 60% of impacted students
- As a result, the proposed Gainful Employment regulations could cause approximately 400,000 students to not attend post-secondary education each year once the regulation is fully in place

What is the Potential Economic Impact?

- Assessing the full economic impact is difficult as it must account for (1) reduced earnings of students who do not attend post-secondary schooling, (2) direct and indirect job losses from reduced enrollment, (3) the increased taxpayer costs of students who choose public post-secondary institutions
- The Parthenon Group's analyses indicates that the economic impact of the proposed regulation could extend to:
  - Job losses of 90,000-100,000 throughout the nation
  - An on-going economic impact of approximately $5B per year

Bridging from ED's impact estimate to a revised estimate

1

5% of programs in the Missouri dataset are ineligible

- ED originally reported that 5% of programs would be ineligible under the new regulation
- In actuality, in the publicly available dataset, 6% of programs are ineligible

2

14% of students are enrolled in ineligible programs based on Missouri dataset

- The 6% figure includes public programs not affected by GE
- When ED's GE tests are applied only to programs subject to GE regulations, 14% of students become ineligible

3

FULL IMPACT: Among programs that are subject to GE regulations, 30% of students are enrolled in programs likely to be ineligible

- After incorporating methodology adjustments (e.g., accommodating for sample bias, changes since 2008, and the national distribution of repayment rates) the impact estimate rises to 30%
- Including estimates for students with private loans and estimating the impact of unemployed and out-of-state students are the most significant drivers of higher estimated ineligibility rates

Source: United States Department of Education Missouri Gainful Employment Analysis; BLS; US Census Bureau; BPS; NPSAS

Proposed ‘gainful employment’ regulation summary of impact estimates

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% of Students	Original ED Estimate		Revised Estimate After Incorporating Proposed Methodological Adjustments	
	All Schools	Subject to GE Regulation	All Schools	Subject to GE Regulation
Ineligible	4%	14%	16%	30%
Restricted	9%	31%	5%	26%
Eligible w/ Disclosure	37%	51%	31%	33%
Eligible	49%	5%	48%	11%

Source: United States Department of Education Missouri Gainful Employment Analysis; BLS; US Census Bureau; BPS; NPSAS; Parthenon Analysis

Proposed 'gainful employment' regulation student transfer assumptions

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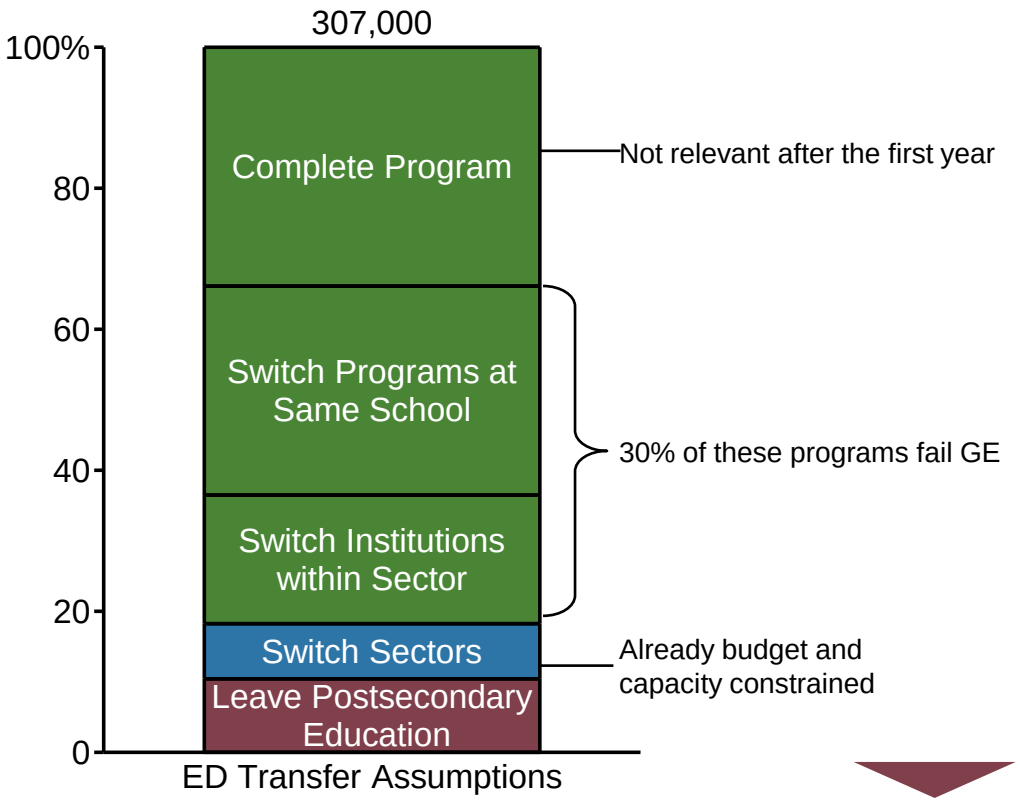
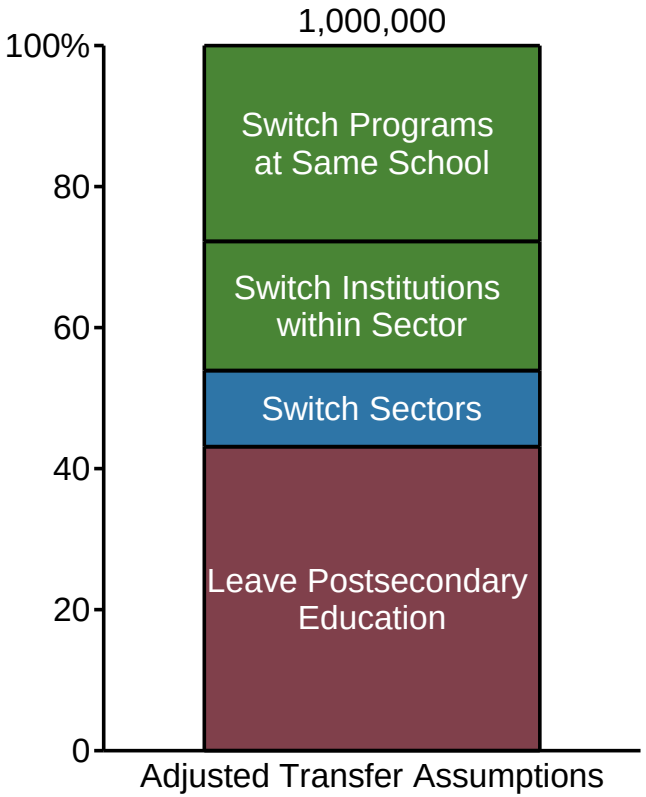
U.S. ED Transfer Assumptions



Adjusted Transfer Assumptions



Adjusted assumptions imply that 300,000 - 500,000 students will likely not complete post-secondary education

Source: U.S. Department of Education NPRM

Proposed 'gainful employment' regulation estimated economic impact

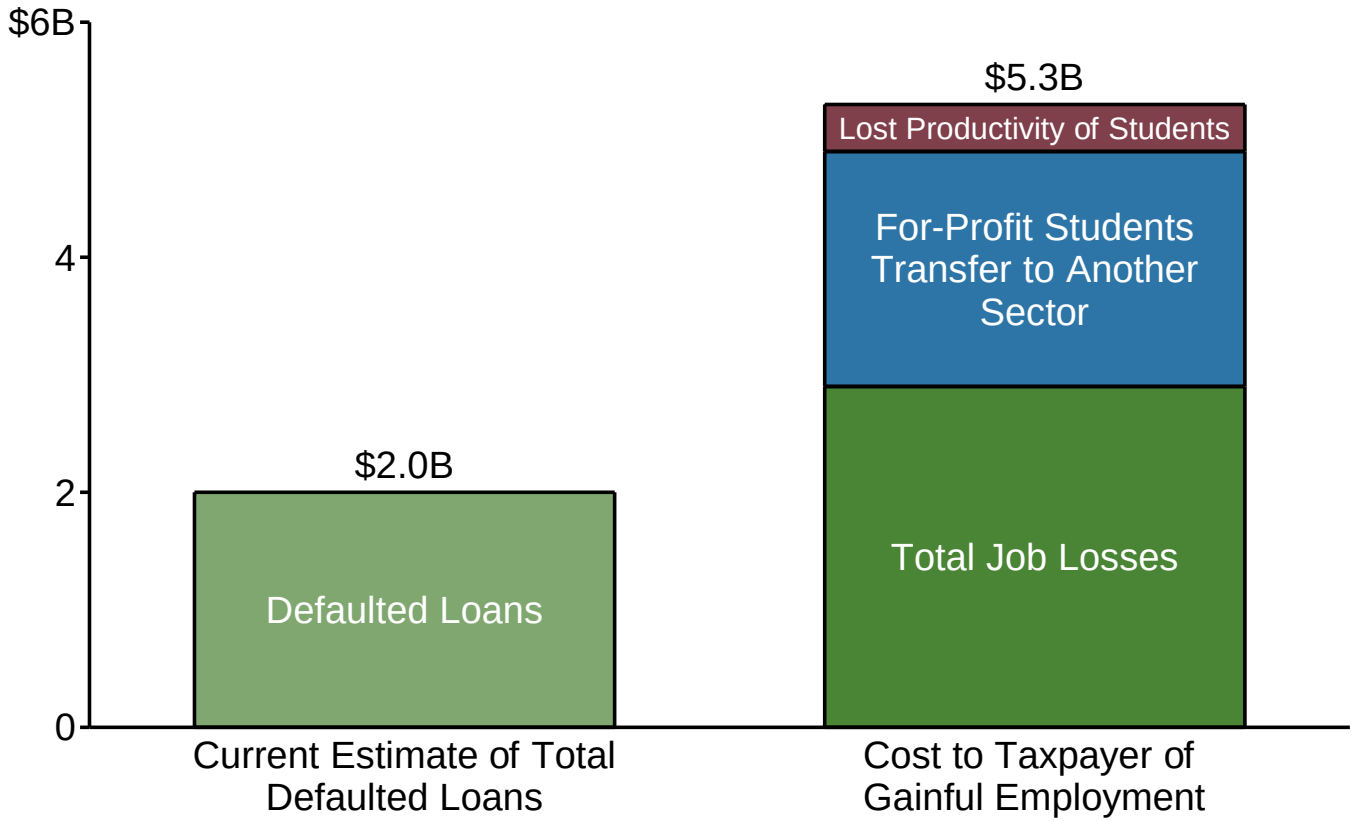
30% of Students Enrolled in Ineligible Programs

Student Impact	Employee Impact	Transfer Impact
• Students who leave post-secondary education earn lower incomes and pay less in taxes • Analysis estimates that young men and women who do not attend post-secondary schools will earn, on average, 13% less over their lifetimes	• Employees laid off pay less in taxes (multiplier effects through the economy as education jobs support other jobs) • 400,000 fewer students will have an impact of approximately 100,000 job loses	• Most displaced students will migrate toward community colleges where direct taxpayer costs are higher • Direct taxpayer subsidies in community colleges is approximately four to five times that of for-profit institutions
~ $400M per year	~ $2.9B per year	~ $2B per year

The estimated economic impact falls into three categories resulting in an estimated increased taxpayer burden of $5.3 billion

GE regulations seek to protect $2B in defaulted federal loans annually; GE implementation will cost taxpayers $5.3B annually

Cost to Taxpayer of Proposed Gainful Employment Regulations vs. Current Estimate of Total Defaulted Loans



Note: Assumes 10-year repayment window and 6.8% fixed interest rate for unsubsidized loans and a 6.0% interest rate for subsidized loans; cash flows are not discounted; loans in default are recovered at the rate of ~20% per year for four years, according to the Student Aid Administration FY10 Budget page 38

Source: College Board, US ED Federal Student Aid Budget Lifetime Default Rates; Student Aid Administration FY10 Budget; US ED Federal Student Aid Annual Report 2009; Department of Education NPRM; NCES IPEDS database; NCES BPS 1996-2001; company financials and SEC filings; BLS; BEA; CBO

Parthenon's perspective has been developed through work across the education landscape

Districts, Government and Foundations

- Chicago Public Schools
- cms Charlotte-Mecklenburg Schools
- NYC Department of Education – Joel I. Klein, Chancellor
- Memphis City Schools
- FOCUS On Children – Boston Public Schools
- University of the State of New York
- Bill & Melinda Gates foundation
- Austin Independent School District
- Michael & Susan Dell FOUNDATION
- the broad foundations

School Networks and Intermediaries

- Noble Network of Charter Schools – Operating Noble Street Charter School
- Internationals Network for Public Schools
- Harlem Children's Zone
- Andre Agassi College Preparatory Academy
- Manipal – Inspired by Life
- YouthBuild U.S.A.
- Good Shepherd Services
- Fund for Educational Excellence
- See Forever Foundation

For-Profit Education Companies

- Laureate Education, Inc.
- Sylvan Learning
- Baring Private Equity Asia
- Hachette Livre
- Reed Elsevier – a world leading provider of information driven services and solutions
- The Princeton Review
- Cengage Learning
- Houghton Mifflin
- DeVry University
- educate, inc.
- Wall Street Institute
- Disney
- The McGraw-Hill Companies

About The Parthenon Group
Background and contact information

About The Parthenon Group

The Parthenon Group is a leading advisory firm focused on strategy consulting with offices in Boston, London, Mumbai, and San Francisco. Since its inception in 1991, the firm has embraced a unique approach to strategic advisory services; long-term client relationships, a willingness to share risk with our clients, an entrepreneurial spirit, and customized insights are the hallmarks for which The Parthenon Group has become recognized in the industry. This unique approach has established the firm as the strategic advisor of choice for CEOs and business leaders of Global 1000 corporations, high-potential growth companies, private equity firms, educational institutions, and healthcare organizations.

About The Parthenon Group Education Center of Excellence

Parthenon has served as an advisor to the education sector since our inception in 1991. Our Education Center of Excellence (ECE) – the first of its kind across management consulting firms – has an explicit mission and vision to be the leading strategy advisor to the global education industry. To achieve this, we invest significantly in dedicated management and team resources to ensure that our global expertise extends across public sector and non-profit education providers, foundations, for-profit companies and service providers, and investors.

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