LAO POLICY BRIEF

California Community Colleges:

Raising Fees Could Mitigate Program Cuts and Leverage More Federal Aid

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As part of the state's effort to close its budget gap, our office has recommended that the Legislature better leverage federal funds to minimize programmatic impacts on state programs and services. As we discuss in our *2009-10 Budget Analysis Series: Higher Education* (see pages HED-24 to 27) and *Federal Economic Stimulus Package: Fiscal Effect on California* (page FED-18) publications, new federal tax credit provisions allow the state to tap potentially hundreds of millions of new federal dollars for higher education. Because these tax credits will fully reimburse most California Community College (CCC) students for the fees they pay, the state could raise those fees (and revenue for CCC) with no net impact on most students. The purpose of this brief is to provide additional information—in a question-and-answer format—related to our recommendation.

How Do Fee Revenues Interact With General Fund Support for CCC?

Each year, the Governor and Legislature specify a total amount of apportionment (general-purpose monies) and categorical-program funding for the CCC system. Apportionment funding comes from three main sources: the state General Fund, local property taxes, and student enrollment-fee revenues. (Categorical programs are funded entirely by the General Fund.) Local property taxes and fees are retained by the community college districts that collect this funding. The General Fund provides the additional funding needed to meet each district's apportionment amount.

In February, the Legislature enacted a preliminary budget for 2009-10 that provides about $5.5 billion in total apportionment funding for CCC (from all three revenue sources). Based on the current charge of $20 per unit (by far the lowest in the country among two-year public colleges), about $300 million of this amount would come from student fee revenues. If fees were increased above $20 per unit, more CCC funding would come from fees.

So, Would the CCC System Benefit From Higher Fee Revenues?

Some assert that community colleges only "benefit" from a fee increase if the revenues from fee increases expand total funding beyond what had been anticipated (resulting in increased overall apportionment levels, for example). We take a different view. Given the state's poor fiscal outlook, it is almost certain that the Legislature will need to reduce state spending, including funding for CCC, from the levels it had anticipated with the February budget package. (In fact, the Governor's May Revision proposes to reduce CCC spending by almost $700 million in 2009-10.) If this is the case, *General Fund support for CCC will drop irrespective of fee levels.* By increasing enrollment fees, the Legislature could fully or partially backfill the lost General Fund monies with fee revenues—thereby minimizing the impact on programs and services. Thus, community colleges would benefit from a fee increase to the extent that it resulted in more total resources for CCC than would have been available without a fee increase. For this reason, we believe that any revenues generated by a fee increase would supplement (not supplant) the level of support the state is able to provide.

How Would Fee Increases Affect Affordability for CCC Students?

Fee Increase Would Not Affect Needy Students Since They Are Not Required to Pay Fees. In considering any fee increase, the Legislature should consider the potential effects on student affordability and access. For CCC students, affordability is preserved through the Board of Governors' (BOG's) fee waiver program. This entitlement program is designed to ensure that community college fees will not pose a financial barrier to any California resident. It accomplishes this by waiving the fees for all residents who demonstrate financial need. As we detail in the *Higher Education* publication of our *Analysis* series (see page HED-25), the program has relatively high income cut-offs. For example, a student with one child could have an income up to roughly $80,000 and still qualify for fee waivers. In recent years, about 30 percent of all community college students (representing over 40 percent of all units taken) have received BOG fee waivers. In 2008-09, about $225 million in fees were waived.

Federal Government Will Reimburse Most Fee-Paying Students. The vast majority of students who do not qualify for BOG waivers are still eligible for federal financial assistance that covers all or a portion of their fees. Figure 1 summarizes the features of the federal American Opportunity tax credit (AOTC), Lifetime Learning Credit, and tuition and fee tax deduction. As we note in our

Figure 1

Federal Tax Benefits Applied Toward Higher Education Fees

2009

American Opportunity Credit	Lifetime Learning Credit	Tuition and Fee Deduction
• Directly reduces tax bill and/or provides partial tax refund to those without sufficient income tax liability.	• Directly reduces tax bill for unlimited number of years.	• Reduces taxable income.
• Covers 100 percent of the first $2,000 in tuition payments and textbook costs. Covers 25 percent of the second $2,000 (for maximum tax credit of $2,500).	• Covers 20 percent of first $10,000 in fee payments (up to $2,000 per tax year).	• Deducts between $2,000 and $4,000 in fee payments (depending on income level).
• Designed for students who: — Are in first through fourth year of college. — Attend at least half time. — Are attempting to transfer or acquire a certificate or degree.	• Designed for students who: — Already have a bachelor's degree. — Carry any unit load. — Seek to transfer or obtain a degree/certificate—or simply upgrade job skills.	• Designed for any student not qualifying for a tax credit.
• Provides full benefits at adjusted income of up to $160,000 for married filers ($80,000 for single filers) and provides partial benefit at adjusted income of up to $180,000 ($90,000 for single filers).	• Provides full benefits at adjusted income of up to $100,000 for married filers ($50,000 for single filers) and provides partial benefit at adjusted income of up to $120,000 ($60,000 for single filers).	• Capped at adjusted income of $80,000 for single filers and $160,000 for married filers.

Federal Economic Stimulus Package report (pages FED-13 and 14), the American Recovery and Reinvestment Act replaced the Hope credit with AOTC in the 2009 and 2010 tax years. (The Hope tax credit would return in 2011, though the President's budget proposes to make AOTC a permanent program. For details on the Hope tax credit, please see our *Higher Education* report [page HED-25].) As the figure indicates, income thresholds for AOTC are high. For example, students (or their parents) with a family income of up to $160,000 in 2009 are eligible for a federal tax credit equal to their fee payment—as well as textbook costs—for up to $2,000 per year. (The amount of the tax credit is gradually reduced between $160,000 and $180,000 for joint returns; $80,000 and $90,000 for single filers.) Therefore, while students still pay fee and textbook costs up front, they would be reimbursed for this cost as a federal income tax credit. In addition, families or students with insufficient tax liabilities qualify for partial tax refunds (equivalent to 40 percent of qualifying expenses).

Students who do not meet AOTC's academic requirements (such as those who already hold a bachelor's degree or only take one course each term) can qualify for the Lifetime Learning tax credit, which provides a tax credit equal to 20 percent of fees. Finally, those not claiming the credits may be eligible for a tax deduction of the cost of fees. We estimate that roughly two-thirds of CCC students would qualify for full fee aid through the BOG waiver program or AOTC. About 90 percent of CCC students would qualify for either a fee waiver or a full or partial tax offset to their fees.

How Much in New Revenue Could Be Generated by Taking Advantage of Federal Tax Assistance?

The AOTC fully reimburses students for 100 percent of the first $2,000 in tuition, fee, and textbook costs. If the state were to increase fees to up to $60 per unit (or $1,800 for a full-time student), eligible students taking 30 units per year would be able to take full advantage of the tax credit—while leaving room to receive some reimbursement for textbook costs.

In 2008-09, student fee revenues totaled about $300 million. Higher fees would generate about $80 million in additional revenues at $26 per unit (the level in 2006), approximately $120 million in additional revenues at $30 per unit, $225 million in additional revenues at $40 per unit, and roughly $500 million in additional revenues at $60 per unit. Even at $60 per unit, CCC fees for a full-time student would still be among the lowest of the country's two-year public colleges. These monies could effectively backfill a reduction in General Fund support for CCC, which would help mitigate the impact on student service levels. (As we note in the *Higher Education* report [see pages HED-26 to 27], the Legislature might consider setting aside a portion of funding generated by any fee increases for purposes of outreach and technical assistance to students on the federal tax benefits.)

What Effect Could Fee Increases Have on Access and CCC Enrollment Levels?

Over time, CCC's enrollment has fluctuated. Between 2002-03 and 2004-05, enrollment dropped by about 11 percent. During this two-year period, fees increased twice: to $18 per unit (from $11 per unit) in 2003-04; and to $26 per unit in 2004-05. The number of students in the system dropped by approximately 300,000, from 2.8 million in 2002-03 to 2.5 million in 2004-05. This equals a decrease of about 50,000 full-time equivalent students (FTES) in credit instruction between 2002-03 and 2004-05 (plus about 10,000 FTES in *noncredit* courses).

Some cite these earlier fee increases as the cause of enrollment decline. Our analysis suggests that this claim about fees being the sole or even the major cause of enrollment declines is exaggerated. In fact, there are several explanations for the enrollment declines.

Crackdown on Concurrent Enrollment. Much of the decline in enrollment from 2003-04 to 2004-05 was an intended result of statutory and budget changes to address systemic abuses involving concurrent enrollment. Beginning in 2002, the Legislature and Governor became concerned that a number of community college districts were inappropriately, and in some cases illegally, claiming state funding for a rapidly increasing number of high school athletes who were "concurrently enrolled" in CCC physical education courses. For 2003-04 the Legislature reduced funding for concurrent enrollment by $25 million and tightened related statutory provisions. As a result, high school students concurrently enrolled in CCC courses dropped from about 100,000 (headcount) in 2002-03 to about 16,000 in 2004-05 (which translates into 15,000 FTES in 2002-03 to less than 2,000 FTES in 2004-05). Thus, *about one-quarter of the enrollment decline can be explained by a drop in these high school students—which was an intended policy reform entirely unrelated to fee increases.*

Reduced Course Offerings. In a 2005 report to the Legislature on enrollment changes at CCC, the Chancellor's Office suggested that an unknown amount of the enrollment decline can be explained by districts having reduced the number of course offerings. This reduction was in response to concerns by districts about possible cuts to the CCC system budget during this period. Community colleges reduced about 10,000 course sections systemwide between fall 2002 and fall 2003. It was not until spring 2005 that CCC fully restored this courseload. With fewer course offerings, some potential students found there was no space in courses they wanted and thus did not enroll. (This is also a possible explanation for why enrollment in noncredit instruction—which is free for all students—declined during this time period.)

Impact of Fees on Nonneedy Students. Although all financially needy students are eligible to receive a fee waiver and CCC fees remained the lowest in the country, it is likely that some students chose not to enroll in a community college as a result of the higher fees imposed in 2003-04 and 2004-05. As we discussed in our *2006-07 Analysis of the Budget Bill* (page E-252), however, data collected by the Chancellor's Office in 2005 and 2006 revealed no disproportionate effect on students from low-income areas or historically underrepresented racial groups. Also, the data revealed a shift toward traditional college-aged students and an increase in the percentage of students attending a CCC full-time.

In summary, a combination of factors likely contributed to earlier CCC enrollment declines, with fee increases having an unknown effect. Similar to that period, however, it is likely that this year some fee-paying students who would have attended when fees were $20 per unit would choose not to enroll when fees are higher (even if they qualified for a full or partial reimbursement from the federal government). Because these students by definition are not financially needy, their decision not to enroll should not be considered a denial of access, but rather a choice they made about the benefit they would have received from a CCC course.

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This report was prepared by Paul Steenhausen, and reviewed by Steve Boilard. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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