Creating a Fair Formula for Allocating Financial Aid
The Cost-of-Living EFC

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A growing chorus of voices across California are calling for a bold investment into financial aid in the state—one that takes a comprehensive approach to assessing overall college costs by addressing both tuition and non-tuition costs. Making such an investment would require a number of reforms to the current aid system, including a more rigorous assessment of how much a family can actually afford to pay in a state with such a high cost of living.

In order to make that determination, we recommend that policymakers:

• shift California’s assessment of financial need, as well as the related calculation of the amount of money a family can reasonably be expected to spend on college, to better align with federal formulas used to determine Pell eligibility;

• send new resources appropriated for non-tuition aid dollars to the lowest-income families first, identifying them through data they already submit as part of the aid process;

• ask the state’s congressional delegation to support a change in federal financial aid formulas that would better account for regional differences in the cost of living; and

• use available data to model a formula adjusted for cost of living and adjust state aid eligibility formulas to account for some of those differences.

Background

In order to receive federal financial aid, each prospective student must fill out the Free Application for Federal Financial Aid (FAFSA) to determine their expected family contribution (EFC). This figure is then used to calculate their financial need in covering their tuition and non-tuition costs, as well as the amount of federal student aid (Pell grants, for example) for which they may be eligible. The federal government sends that record to the California Student Aid Commission (CSAC), which uses some of the record’s data to calculate whether a student meets the criteria of CSAC’s own income and asset test. If they do, the student is awarded a Cal Grant. The income and asset cut-off for receiving a Cal Grant is written into statute and is adjusted each year based on changes in cost of living. Anyone just above the income and asset cut-off receives no Cal Grant at all.

This issue brief can be found online at: https://tcf.org/content/commentary/creating-fair-formula-allocating-financial-aid-cost-living-efc/.
In an April 2018 report, The Century Foundation recommended that the state base Cal Grant eligibility on a modified version of the EFC formula. In doing so, policymakers would better align their aid system with the federal government’s and base aid on a family’s ability to pay both tuition and non-tuition costs, while also removing the cliff effects created by the existing Cal Grant income and asset thresholds. While policymakers could still guarantee full tuition coverage up to a certain income threshold, the Cal Grant (or a combination of Cal Grant and institutional aid) could also focus on covering non-tuition costs for families with financial need, as determined by a localized version of the EFC. The Cal Grant could phase down its coverage of non-tuition expenses as EFC increases and financial need decreases.

Under this new system, TCF recommended that, in calculating how much a family could afford to pay toward the total cost of attendance, California policymakers use data already submitted by families to identify the highest-need students, and use data on local housing and other costs for developing an EFC that is adjusted for regional cost-of-living differences. TCF recommends ultimately that this cost-of-living EFC be adopted at the federal level, but that it would in the meantime be used for the state aid program.

**Creating a Cost-of-Living Expected Family Contribution**

By using federal EFC data, California can align its assessment of financial need with the federal government’s to determine Pell grant eligibility, while using that same information to make a fairer assessment of the resources available to California students and families.

As it stands, the EFC formula looks at both a given family’s annual income received and assets held, taking into account the number of children the family has in college. The formula makes a number of adjustments, such as excluding assets like a primary residence, retirement funds, or a portion of net worth owned through a small- or medium-sized business.

**Prioritizing Lowest Income Families First**

Currently, all families that are judged by the federal aid formula to be unable to put any resources toward college are deemed “zero-EFC,” meaning that they qualify for a full Pell grant and in California would also likely qualify for a Cal Grant. However, those zero-EFC families vary in the extent of their need, and those students would still likely have significant unmet financial need—the balance left over after the Pell Grant, a Cal Grant covering tuition, and work (and/or loans) are subtracted from the cost of attendance.

We have recommended California expand its non-tuition grant aid to, over time, close those unmet need gaps and reduce that loan expectation. As the state increases the dollars it sends to students with unmet need to cover those non-tuition expenses, it should incentivize schools to fill those gaps in need for the lowest income students first—students from zero-EFC families. If the initial dollars are limited, it may require further analysis to determine who within that cohort has the deepest need—the poorest of the zero-EFC families—to direct new non-tuition dollars to those families first.

**Adjusting for Local Costs**

Despite all of its complexity, other than an adjustment for state income taxes, the federal EFC formula fails to use information that the department already possesses to take into account other state-by-state, or even intra-state, variations.

Housing costs are a particularly severe oversight. Under the federal formula, a family of four with a household income of $70,000 will be expected to contribute the same amount of money to their child’s college costs as a family with the same income and assets, but living in an area where the cost of living is far higher. This means that, for example, the same family facing higher rent may have thousands of dollars less in discretionary income that could go to paying down college costs. Those differences are substantial even within California: there are counties of California where rent costs four times as much as they do in low-cost counties in...
other states. Figure 1 illustrates the impact of rent for two adjacent California counties with vastly different rent prices.

While the state cannot change the EFC formula for purposes of federal aid, we recommend petitioning Congress to adjust the EFC to take cost of living into consideration. Further, the state can model the approach by using a cost-of-living adjustment to the formula when using it to determine eligibility for state aid. This approach would use the federal formula as the minimum baseline, but then set aside additional income for families living in high-cost rent areas of the state. Because the state already knows where a student’s family lives, it would require no additional information from the student.

There are several ways that a formula could account for higher living costs. One could base an adjustment off commuting zones, which tend to delineate local economies. The military creates adjustments for their GI Bill housing allowances by zip code, another generally reliable point of delineation. Maryland does something similar: it adjusts the EFC used to calculate two of their grant aid programs based on geographically clustered zip codes. One could also make adjustments according to both housing prices and available housing stock, though researcher Robert Kelchen argues that an adjustment based on housing quality may be difficult to perform accurately. Instead, he recommends adjusting based on county-level cost estimates from a crowd-sourced cost of living index known as COLI. However, this valuable dataset does not currently cover all counties, and so would not be immediately usable across the state.

We recommend a similar approach to Kelchen’s, focusing on housing but using a federal dataset, the United States Department of Housing and Urban Development (HUD)’s Fair Markets Rent system, which it uses to calculate housing vouchers, covers all of the counties in California, and would not rely on state or external entities for updates.
In order to make the EFC calculation work for California, we recommend that policymakers:

• use the federal EFC formula as the first step in determining the ability of families to pay;

• Adjust the EFC for families with no expected family contribution to identify the lowest income families and prioritize those families when allocating additional cost of living dollars (though such an adjustment becomes unnecessary and can be phased out if the state funds the full cost of attendance for students from families with a zero-EFC); and

• adjust upward the income protection allowance (IPA) in the EFC formula to protect at least a percentage of the extra income spent on housing costs in high cost regions, basing the adjustment on housing data available through HUD’s Fair Markets Rent system.

Conclusion

Creating an EFC formula tailored to the realities of life in California will better respond to the financial demands facing California families. Creating it will require no additional information on the part of students and families, and would also provide a model for federal lawmakers to consider in future congressional reforms.

Authors

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Notes

5 See The Century Foundation’s issue brief “Financial Aid for the Full Cost of College,” published February 25, 2
11 C2ER, The Council for Community and Economic Research, http://coli.org/. Kelchen notes that a drawback of using this index is that it focuses on the typical expenditures for married urban professional households in the top income quintile, which may be well above those of most college students and their families. However, he points out that the relative differences in expenditures across areas may be reasonable.