OLO Report 2017-8 June 27, 2017

Student Loan Refinancing Authority

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OLO Office of Legislative Oversight

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Executive Summary

Student loan debt in the United States reached $1.28 trillion in 2017, with 44.2 million residents having an average monthly payment of $351. Refinancing a student loan can help borrowers by lowering interest rates or reducing the length of the loan period – lowering monthly payments and/or lowering the overall amount of repayment.

Neither the state of Maryland nor Montgomery County currently have a student loan refinancing authority. In 2016, the Maryland State legislature passed enabling legislation to allow Montgomery County to establish a Student Loan Refinancing Authority (SLRA). Before the County can establish a SLRA, the enabling legislation (House Bill 1079) requires the County to conduct a study that, among other things, examines feasibility and demand and studies the operations of similar refinancing authorities in other systems. The Council asked the Office of Legislative Oversight undertake the study by executing a feasibility and demand study, assessing potential benefits to recruitment and retention, and studying the operation of similar programs in other systems, including operating and startup costs.

OLO's research shows that it would be feasible to establish a student loan refinancing authority in Montgomery County. However, fully analyzing market demand in the County would require the determination of **major program characteristics and a professional market study.**

State Student Loan Program Characteristics

No U.S. counties operate a student loan revenue or refinancing authority. Consequently, OLO studied the 15 state-level programs listed below. Twelve of the 15 programs offer student loans AND student loan refinancing options.

State Student Loan Programs Studied

- **The Alaska Commission on Postsecondary Education**
- **Bank of North Dakota**
- **Connecticut Higher Education Supplemental Loan Authority**
- **Finance Authority of Maine**
- Higher Education Student Assistance Authority (New Jersey)
- **Iowa Student Loan**
- **Kentucky Higher Education Student Loan Corporation**
- **Louisiana Education Loan Authority**
- **Massachusetts Educational Finance Authority**
- **Minnesota Office of Higher Education**
- **New Hampshire Education Loan Corporation**
- **Rhode Island Student Loan Authority**
- **South Caroline Student Loan**
- Texas Higher Education Coordinating Board
- Vermont Student Assistance Corporation

Programs in **BOLD** offer student loan refinancing.

The table on the next page summarizes the eligibility requirements and main program characteristics of these programs.

State Student Loan Refinancing Program Characteristics Summary

Eligibility Requirements	
Residency	Typically, resident of the state or out-of-state resident attending a school within the state. A few programs are open to all US citizens or permanent residents.
Employment or Income	Borrower or co-signer must be employed and/or have a minimum income (typically $20K to $40K).
Minimum Credit Score	FICO score typically between 670 and 720 FICO, or meet other authority's credit standards.
Maximum Debt-to-Income Ratio	30% to 50%.
Completed Degree	Most do not require a borrower to have completed degree.
Maximum Loan Amount	Range from $70,000 to no maximum. Most common is $150,000.
Minimum Loan Amount	Typically, $7,500 or $10,000. Some have no minimum.
Interest Rates*	Fixed interest rates range between 3.49% and 8.55%; variable rates range between 2.35% and 6.31%.
Fees	Most do not charge fees for the application, origination, disbursement, or prepayment of the loan.
Repayment Term Length	Most are 5, 10, or 15 years. Some also have 20 and 25 year options.
Loan Forgiveness	If a borrower dies or becomes totally and permanently disabled.

**Rates are from December 2016*

Startup and Operating Costs for State Programs

State student loan refinancing programs typically receive initial funding from loan proceeds from a state loan authority's private loan program – generally between 10% and 15% of the total loan amount for the refinance program is needed for collateral (assets pledged as a recourse to a lender if a borrower defaults on an initial loan). For example, a $10 million student loan refinancing program would need $1 - $1.5 million in collateral. A program that is new to the student loan market and is not funded by proceeds from an existing loan program would require collateral of 20% or more, or at least $2 million in this example.

Most of the state student loan refinancing programs started their first year as a pilot program, with an average of about $7.5 million in loan refinancing, and then increased funding in their second year. Operating costs for these programs can vary depending on the size of the program and whether staff are hired directly or on contract. Several programs used existing staff from their private student loan program. Program costs in Rhode Island, Louisiana, and Connecticut were reviewed due to their similarities with Montgomery County (population size and/or just starting a student loan refinancing program). Initial or one-time costs range from $175,000 to $400,000 and annual operating costs range from $708,000 to $1,028,000.

Student Loan Figures and Determining Demand

Based on the most recent figures, the average student loan debt for graduates in Maryland was $27,672, which is less than the national average of $30,100. Maryland's education loan market is the 24th largest the country and it is dominated by federal student loans. Reviewing student loan data by zip code in Montgomery County, most zip codes in Montgomery County have residents with high student loan balances and with a low delinquency rate (when borrowers make late payments). The County did not have any zip codes that had both low median income levels and low average student loan balances – the group most typically delinquent with loan payments.

The student loans debt characteristics of Montgomery County residents provides evidence of demand in the County for a student loan refinancing program. However, the full extent of the demand for a student loan refinancing authority cannot be accurately determined until key program characteristics are set, such as residency status, minimum credit score/credit history requirements, minimum/maximum loan amounts, interest rates, fees, and forgiveness options. Once program characteristics are set, a professional market study can accurately determine demand.

Feasibility of Implementing a Student Loan Refinancing Authority

A Montgomery County Student Loan Refinancing Authority would be feasible if the following legal and program requirements are met:

Legal Requirements*

- Perform a feasibility and demand study
- Assess the potential benefit to recruitment and retention of county and school system employees
- Study the operation of similar programs in other systems, including operating costs
- Hold public hearings
- Provide an opportunity for public comment
- Pass an ordinance (bill)

* From HB1079

Program Requirements

- Determine the program characteristics and the market
- Fund startup and operating costs
- Create realistic revenue expectations
- Issue bonds for financing
- Hire qualified staff and/or contractors
- Acquire physical office space/resources

This study fulfills the first three legal requirements and the process of enacting a local law establishing an authority would address the last three. Stakeholders would need to determine the key program characteristics and a professional market study can help determine the market and realistic revenue expectations. A market study could also help determine the size of a program, which can dictate staffing/contractor, space, and resource needs. Finally, the state-approved Montgomery County Student Loan Refinancing Authority enabling legislation provides the County the authority to issue bonds to finance a program.

Policy Considerations when Establishing a Student Loan Refinancing Program

While all student loan programs have at their core the goal of reducing or making student loan debt more affordable, program eligibility requirements can target programs to specific groups of student loan holders if policymakers seek to fulfill a specific public policy goal. To help refine these requirements, the Council can consider program characteristics, which can be divided into two general categories: (1) technical characteristics such as credit scores, amount of debt, interest rates, and applicant income levels and residency status; and (2) eligibility based on desired public policy goals.

The tables on the next page summarize the technical program characteristic questions and policy goals to consider (not an inclusive list of all potential policy considerations).

Technical Program Characteristic Questions

Residency	Open only to County residents? Maryland residents? Out-of-State residents attending a school in Montgomery County (e.g., Montgomery College)?
Employment/Income	Employment required? Minimum income? Both?
Credit	Minimum FICO score? Effect of previous loan delinquencies or bankruptcies? Maximum debt-to-income ratio?
Degree	Does borrower have to have a completed degree? Two-year and/or four-year programs? Eligibility of certificate programs?
Loan Amount	What will the minimum and maximum loan amount be? As high as the cost of school attendance?
Fees and Payment Options Interest Rate	Will there be any fees, such as an application fee? Will the payment terms be for 15 years? 20 years? Market rate interest? Lower rates to provide an incentive not offered by other lenders?

Policy Goals to Consider

Assisting Students with Debt and/or College Access	Program proceeds can go towards helping existing students. For example, proceeds of the Texas Higher Education Coordinating Board's bonds are used to make low interest loans to students in undergraduate, graduate, and professional education programs at Texas public or private colleges and universities. Other state programs help with college access (include grants) and financial literacy.
Recruiting and Retaining County Professionals	Interest rate reductions and/or loan forgiveness targeted to certain professions such as teachers, police, firefighters, county government employees, etc., can help with recruitment and retention.
Targeting Specific Low-Income or Disadvantaged Groups	Examples include "first-in-family" students who are the first ones to go to college; low-income families who have difficulty meeting minimum loan income requirements; and students from disadvantaged backgrounds.
Encouraging Increased Home Ownership	Programs can target first-time (or other) home buyers in a particular jurisdiction. Augmenting Montgomery County's first time homebuyer credit program with the ability to refinance student loans could encourage new homebuyers to choose Montgomery County over other local jurisdictions such as Fairfax County and Washington, DC.

OLO Recommendations and Discussion Question

As the Council considers establishing a Montgomery County Student Loan Refinancing Authority, OLO recommends that the Council consider the following recommendations and discussion question.

Recommendations

1. Determine technical and policy characteristics; engage a consultant to conduct a market demand study.

2. **If the Council wants to establish a student loan refinancing authority, consider establishing it as a component of the Montgomery County Revenue Authority.**

Discussion Question

1. Should the County wait until the study currently in progress by the Maryland Department of Legislative Services (DLS) about a State student loan refinancing authority is complete?

For a complete copy of OLO-Report 2017-8, go to:http://www.montgomerycountymd.gov/OLO/Reports/CurrentOLOReports.html

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Introduction

Refinancing student loans can save borrowers money by providing better interest rates and/or allowing borrowers to pay off a loan faster, pay less in the long run, have fewer bills, or have more liquid assets. While student loan refinancing is not the best solution for every borrower, it can be a useful financial tool for some.

The federal government does not provide student loan refinancing options. Accordingly, several states, including Alaska, Connecticut, Massachusetts, and Rhode Island, have established student loan refinancing programs to provide this service to student loan borrowers. State-level student loan financing programs are expanding – especially with options for loan refinancing (most of the current refinancing programs started within the past four years). States such as New Jersey, Virginia, and Wisconsin are in the process of taking steps to establish refinancing programs.

Neither the state of Maryland nor Montgomery County currently have a student loan refinancing authority. In 2016, the Maryland State legislature passed enabling legislation to allow Montgomery County to establish a Student Loan Refinancing Authority (SLRA). Establishing an SLRA in Montgomery County would require additional County legislation. Before the County can establish a SLRA, the enabling legislation (House Bill 1079) requires the County to conduct a study that, among other things, examines feasibility and demand and studies the operations of similar refinancing authorities in other systems.

Based on separate state legislation (House Bill 1015), education authorities in Maryland are conducting a parallel study to this one for a state-wide refinancing authority – expected in fiscal year 2018. House Bill 1015:

> Requires the Maryland Higher Education Commission and the Maryland Health and Higher Educational Facilities Authority, in consultation with the Department of Legislative Services and any other appropriate agencies, to study the expansion or creation of an appropriate bonding authority for the refinancing of student loans in Maryland…requiring the study to examine specified matters and to report the findings and recommendations on or before September 30, 2017.[1]

Staff at the Department of Legislative Services indicate that the relationship between a County refinancing authority and a separate state refinancing authority is not immediately clear without a specific bill to create a state authority.

The purpose of this report is to fulfill the requirement to conduct a study related to a Montgomery County SLRA, as required by HB 1079. The report is organized as follows:

- <u>Chapter 1 – Student Loan Program Characteristics:</u> discusses state student loan programs, student loan terminology, and state student loan refinance programs' attributes.
- <u>Chapter 2 – Startup and Operating Costs for State Programs:</u> reviews startup costs and initial refinancing loan program totals, operating costs, and types of financing/bonds.
- <u>Chapter 3 – Student Loan Figures and Determining Demand:</u> reviews student loan data nationally and in Maryland, student loan data for Montgomery County, and demand and professional guidance.
- <u>Chapter 4 – Feasibility of Implementing a Student Loan Refinancing Authority:</u> reviews the legal and program requirements.

[1] 2016 Laws of Maryland, Chapter 290 (House Bill 1015), Study of Student Loan Refinancing in Maryland, available at http://mgaleg.maryland.gov/2016RS/chapters_noln/Ch_290_hb1015T.pdf

- Chapter 5 – Policy Considerations when Establishing a Student Loan Refinancing Program: reviews policy questions and considerations related to student loan refinancing programs. This chapter also reviews existing programs addressing student loan debt in Maryland.
- Chapter 6 – Report Findings, Recommendations, and Discussion Question: summarizes the report's findings and presents recommendations and a discussion question.

Office of Legislative Oversight (OLO) staff member Blaise DeFazio conducted this study, gathering information through document reviews and interviewing staff from state student loan authorities, the Education Finance Council, and Bank of America Merrill Lynch. OLO also received guidance and assistance from staff in Montgomery County Public Schools (MCPS) and the staff from the Montgomery County Department of Finance, the Office of Intergovernmental Affairs, Office of Human Resources, and County Council legal staff.

OLO received a great level of cooperation from everyone involved in this study. OLO appreciates the information shared and the insights provided by all who participated. In particular, OLO thanks:

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- Tricia Dubroc from the Louisiana Education Loan Authority

CHAPTER 1. State Student Loan Program Characteristics

This chapter provides an overview of the state student loan program characteristics and is organized into three sections.

- **Section A**, Introduction to State Student Loan Programs;
- **Section B**, Student Loan Terminology; and
- **Section C**, Attributes of State Student Loan Refinance Programs.

A. Introduction to State Student Loan Programs

Students who need money to pay for the cost of attending secondary education institutions (e.g., college, graduate school) can take out student loans. The federal government, some state student loan authorities, and private lenders provide options for students to borrow money for education costs. State loan programs administer several different types of loan programs, described generally below.

Student Loans or Supplemental Education Loans – These loans cover gaps when federal loans are not enough to cover the cost of attendance for undergraduate degrees, graduate degrees, or certification programs (such as aviation). These loans directly compete with the US Department of Education/ Federal Student Aid Office's Direct PLUS Loans, which do not have the same protections as other federal loans (i.e., forgiveness, income-driven repayment).

Parent or Family Education Loans – Programs that allow family members to take out a student loan on behalf of a student (i.e., spouses, parents, foster parents, step-parents, and grandparents).[2]

Refinanced Loans – These loans replace a student loan or loans with a new loan with different terms. Borrowers can combine both federal and private education debt by refinancing and will receive a new (often lower) interest rate based on the borrower's credit history. The federal government does not offer loan refinancing and federal borrowers lose federal loan protections, such as loan forgiveness or income-driven repayment plans, when refinancing.[3] State authorities often provide information for borrowers to ensure that the benefits of refinancing federal loans will outweigh lost protections.

Consolidated Loans – These programs allow borrowers to combine two or more state loans into one with a new interest rate (the weighted average of the combined loan rates). Consolidated loans typically provide a longer repayment term and lower monthly payments. Borrowers can combine eligible federal student loans under the Direct Consolidation Loan program, but may lose benefits such as interest rate discounts, principal rebates, or some loan cancellation benefits.[4]

[2] Description of Family Education Loans by the Alaska Commission on Postsecondary Education, available at http://acpe.alaska.gov/FINANCIAL_AID/Loans/Family_Education_Loans

[3] Massachusetts Educational Financial Authority, Education Loan vs. Refinancing, available at http://www.mefa.org/education-loan-consolidation-vs-refinancing/

[4] US Department of Education's Federal Student Aid Office: Loan Consolidation, available at https://studentaid.ed.gov/sa/repay-loans/consolidation#should-i

Teachers Loan Programs – South Carolina Student Loan provides loans towards applicants who will teach in a critical subject or a critical geographic area. The loans can be forgiven at a certain rate or amount, depending on the length serving in a critical subject or geographic area.[5]

Before 2010, state programs could also administer federally insured loans. The Health Care and Education Reconciliation Act of 2010 ended the federal government's provision of subsidies to private banks or authorities to give out federally insured loans. Instead, the federal government directly administered federal loans,[6] which "would eliminate the fees banks get to act as the middlemen, saving the government billions of dollars."[7]

This Act dramatically affected state student loan authorities. The state authorities were considered private (anything not federal is considered private) and state authorities could no longer have a relationship or partnership with colleges and universities and would only be allowed to recommend federal loans. Most state authorities saw a drop in the number of student loan disbursements and the burden switched to students and parents to seek out the private/state loans that may be a better deal than the Federal PLUS loans.

Most state programs are run by student loan authorities with exceptions like North Dakota, whose program is run by the state's Bank of North Dakota. Some of the larger programs, like South Carolina Student Loan, also provide loan services for other states. The table below summarizes the states studied for this report, their student loan authorities, and the main types of loans they provide.

Table 1-1. State Student Loan Authorities and Loan Types Offered

State	Authority	Loan Types
Alaska	The Alaska Commission on Postsecondary Education	Student, Refinanced, Family
Connecticut	Connecticut Higher Education Supplemental Loan Authority	Student, Refinanced
Iowa	Iowa Student Loan	Student, Refinanced
Kentucky	Kentucky Higher Education Student Loan Corporation	Student, Refinanced, Parent
Louisiana	Louisiana Education Loan Authority	Refinanced
Maine	Finance Authority of Maine	Student, Refinanced
Massachusetts	Massachusetts Educational Finance Authority	Student, Refinanced
Minnesota	Minnesota Office of Higher Education	Student, Refinanced
New Hampshire	New Hampshire Higher Education Loan Corporation	Student, Refinanced
New Jersey	Higher Education Student Assistance Authority	Student, Consolidation
North Dakota	Bank of North Dakota	Student, Refinanced
Rhode Island	Rhode Island Student Loan Authority	Student, Refinanced, Parent
South Carolina	South Carolina Student Loan	Student, Refinanced, Teacher
Texas	Texas Higher Education Coordinating Board	Student
Vermont	Vermont Student Assistance Corporation	Student, Parent

Source: State student loan authority websites located in Appendix A.

[5] SC Teachers Loan Programs, available at https://www.scstudentloan.org/students/loanprograms/scteachersloanprograms.aspx
[6] H.R.4872 – Health Care and Education Reconciliation Act of 2010, summary available at https://www.congress.gov/bill/111th-congress/house-bill/4872
[7] FAQs About Student Loan Reform by CNN's John Helton, Kristi Keck, and Jennifer Liberto, available at http://www.cnn.com/2010/POLITICS/03/30/student.aid.faqs/

B. Student Loan Refinancing Terminology

Student loan *refinancing* occurs when a borrower replaces an existing student loan with a new loan with different terms. Below are the definitions of student loan refinancing terms used throughout the report:[8]

Interest – A loan expense charged for the use of borrowed money. Interest is paid by a borrower to a lender. The expense is calculated as a percentage of the unpaid principal amount of the loan.

Interest Rate – The percentage at which interest is calculated on the borrower's loan(s).

Annual Percentage Rate – The interest rate plus additional loan fees such as fees for processing an application (origination fees). Most state student loan authorities do not charge fees for refinancing and the interest rate and Annual Percentage Rate (APR) are equal. Borrow decisions, such as temporarily postponing loan repayments (forbearance) may increase an APR.

Debt-to-Income Ratio – A borrower's monthly debt payments divided by their gross monthly income. This number is one way lenders measure a borrower's ability to manage loan repayment.

Credit Score – A credit score predicts how likely a borrower is to pay back a loan on time. Lenders use a mathematical formula – called a scoring model – based on information from a borrower's credit report to create a credit score and scoring models vary from lender to lender. Lenders use the scores to make decisions such as whether to approve a loan or what interest rate to charge a borrower. A higher credit score increases the likelihood of qualifying for a loan or securing a particular interest rate.

FICO Score – The FICO Score is a credit score created by the Fair Isaac Corporation and is the standard used across state student loan financing authorities. Lenders use borrowers' FICO scores along with other details on borrowers' credit reports to assess credit risk and determine whether to extend credit. FICO scores are based on factors in five areas: payment history, current level of indebtedness, types of credit used, length of credit history, and new credit accounts.

Forgiveness: The cancellation or discharge of a loan where the borrower is no longer expected to repay a loan. At the state level, forgiveness usually occurs if a borrower dies or is totally and permanently disabled. South Carolina offers a forgivable loan program for teachers and career changers who go into teaching and teach in a critical subject or a critical geographic area.

C. Attributes of State Student Loan Refinancing Programs

This section summarizes attributes of state loan refinancing authorities – programs with loan refinancing – because those programs are most like the refinancing program that the Maryland legislature authorized in Montgomery County's Student Loan Refinancing Authority enabling legislation. It describes loan program eligibility requirements, maximum and minimum loan amounts, and other components for existing loan refinancing programs in Alaska, Connecticut, Iowa, Kentucky, Louisiana, Maine, Massachusetts, Minnesota, New Hampshire, North Dakota, Rhode Island, and South Carolina. OLO obtained information through the states' websites and through interviews with state authorities, with assistance from the Education Finance Council.

[8] Terms are from the US Department of Education's Federal Student Aid Office, available at https://studentaid.ed.gov/sa/glossary ; from SoFi, available at https://www.sofi.com/; from the Consumer Financial Protection Bureau, available at http://www.consumerfinance.gov/askcfpb/ ; and from http://www.investopedia.com/

Eligibility

This section describes eligibility requirements for the 12 state student loan refinancing programs examined related to:

- Residency,
- Employment,
- Income,
- Credit scores and history, and
- Debt-to-income ratio.

All the programs examined require that the loan holder be a US citizen or a permanent resident, but state residency requirements vary from state-to-state. Many of the state refinancing authorities require that the borrower be a state resident or a non-resident who went to school in that state because those programs are financed with tax-exempt Qualified Student Loan Bonds that have an Internal Revenue Service requirement that "the student has a nexus to the State (student nexus requirement) for loans made to refinance student loans (refinancing loans)."[9] State programs who serve a broader audience use a mix of non-tax exempt bonds and tax exempt bonds. There are no state refinancing programs that are limited to a certain niche or business profession.

All the 13 refinancing programs studied[10] require that the borrower have a regular source of income ($18,000 to $50,000 for the programs examined) or that the borrower be employed. Borrowers who do not qualify for a program on their own can use a cosigner to help meet eligibility requirements.

The next table summarizes requirements related to residency, employment, and income.

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[9] Internal Revenue Bulletin: 2015-48 by the Internal Revenue Service, available at https://www.irs.gov/irb/2015-48_IRB/ar08.html

[10] North Dakota only has an income requirement for higher loan amounts.

Table 1-2. Residency, Employment or Required Minimum Income

States	Residency Requirement	Employment or Required Minimum Income
Alaska	State residents (regardless of school location); non-residents who attend a participating school in Alaska.	Borrower or cosigner must be employed or have a regular source of income.
Connecticut	State resident; non-residents with student loans through the CT Higher Education Loan Authority.	A student or co-applicant(s) (if any) must have a minimum $20,000 adjusted gross annual income (AGI). No maximum income limit.
Iowa	State residents; non-state residents (higher interest rates).	Borrower must have $25K in annual income and provide continuous employment verification for prior years.
Kentucky	Residents of Alabama, Georgia, Indiana, Kentucky, Mississippi, Missouri, Ohio, Tennessee, Virginia, and West Virginia.	Borrower must have an income of $1,500/month without a cosigner ($18K annually); $2,000/month with a cosigner ($24K annually).
Louisiana	State residents.	Borrower must have an annual income of at least $25K.
Maine	State residents; non-residents who attended a Maine college or university.	Borrower or cosigner must have $24K minimum annual income; cosigner (if any) must have a minimum of two years of work history.
Massachusetts	A US citizen or permanent resident.	Borrower must have an income of $2,000/month or $24K annually.
Minnesota	State residents.	Borrower must be currently employed with the same employer for at least 60 days.
New Hampshire	A US citizen or permanent resident.	Borrower must have an annual income of $30K for loans up to $100K and $50K for loans over $100K.
North Dakota	State residents who have lived at a North Dakota address for six months; non-residents who have a student loan through the Bank of North Dakota (DEAL Student Loan).	Based on loan amount; typically, only requires a credit check, higher loan amounts require income and an analysis of debt-to-income ratio (not a set number).
Rhode Island	Borrowers who reside in any state (potential for lower interest rates for Rhode Island residents).	Borrower must have an income of $40K.
South Carolina	State residents.	Borrower must be employed.

Source: State student loan authority websites located in Appendix A.

Ten out of the twelve states researched have a minimum FICO score requirement, which ranges from 670 to 720. This array clustered around the national average FICO score of 695, which lenders consider a "good" rating and a good borrower.[11] The state programs require that borrowers not be in a grace period, deferment, or forbearance for current student loans and some require that borrowers have no charge-offs (debt that will not be collected by a creditor), repossessions, collection accounts, judgements, foreclosures, garnishments by credit providers (court order that money or property be seized to satisfy a debt), or tax liens.
Nine out of the twelve states studied impose maximum debt-to-income ratios (a borrower's monthly debt payments divided by monthly gross income) and set limits ranging from 36% to 50%, with half of the states

[11] Understanding FICO Scores by the Fair Issac Corporation, available at https://www.myfico.com/Downloads/Files/myFICO_UYFS_Booklet.pdf

above 40%. Financial experts consider a debt-to-income ratio of 43% the highest ratio a borrower can have and still have a qualified loan or stable loan features (more protections).[12] Larger entities can go above 43%, but the Consumer Financial Protection Bureau recommends following guidelines they publish to determine if a borrower can repay a loan.

All lenders require a cosigner for borrowers who cannot meet minimum credit requirements. A cosigner is legally obligated to pay loan payments on behalf of a borrower if the borrower does not make the payments. Lenders often encourage borrowers to have a cosigner, which can lower loan interest rates for the borrower. Minnesota requires a cosigner if a borrower is not a US citizen.

[12] What is a debt-to-income ratio? Why is the 43% debt-to-income ratio important? By the Consumer Financial Protection Bureau, available at http://www.consumerfinance.gov/askcfpb/1791/what-debt-income-ratio-why-43-debt-income-ratio-important.html

Table 1-3. Credit Score and Credit History; Debt-to-Income Ratio

States	Minimum Credit Score and Credit History	Maximum Debt-to-Income Ratio
Alaska	720 FICO score (can apply with a cosigner if FICO score is lower than 720).	36% (only required for applicants or cosigners not employed or the loan is above $80,000; does not include monthly expenses such as utilities, auto insurance, or food).
Connecticut	Acceptable FICO scores, as determined via a TransUnion credit report.	43%
Iowa	720 FICO score. No more than two accounts reporting 30-day delinquencies and no delinquencies of 60 days or more during the previous two years. No previous bankruptcies, charge-offs, repossessions, collection accounts, judgments, foreclosures, garnishments by credit providers, or tax liens.	40% (25% excluding mortgage or rent)
Kentucky	670 FICO score for both the borrower and cosigner.	38%
Louisiana	700 FICO score. No more than two accounts reporting 30-day delinquencies and no delinquencies of 60 days or more during the previous two years. No previous bankruptcies. No defaults on any private or government student loan. No charge-offs, repossessions, collection accounts, judgments, foreclosures, garnishments by credit providers, or tax liens.	40% (25% excluding mortgage or rent)
Maine	680 FICO score and meets credit criteria for loan approval.	Varies by individual financial institution.
Massachusetts	Meets Massachusetts Educational Financing Authority credit standards. Has an established credit history. No history of default on an education loan. No history of bankruptcy or foreclosure in the prior 60 months.	$1,200 available monthly funds after expenses are paid.
Minnesota	720 FICO score and no delinquencies on loans.	45%
New Hampshire	720 FICO score. No current involvement in a bankruptcy proceeding or in any bankruptcy filings during the prior 10 years. No defaults on education loans.	43%
North Dakota	700 FICO score. No loans in delinquency or default.	Based on loan amount; typically only requires a credit check, higher loan amounts require income and an analysis of debt-to-income ratio (not a set number).
Rhode Island	680 FICO score and meets credit criteria for loan approval.	50%
South Carolina	675 FICO score and meets credit criteria for loan approval.	30%

Source: State student loan authority websites located in Appendix A.

Completed Degree

Ten out of twelve state refinance programs examined for this report do not require the borrower to have a completed degree or certificate. Kentucky requires a completed degree/certificate for non-residents and Minnesota requires a completed degree/certificate for residents and non-residents. Allowing borrowers with incomplete degrees to refinance loans expands refinance options to this group who tend to have lower incomes.[13]

Other Requirements

South Carolina requires that the applicant has at least one external eligible education loan not held by South Carolina Student Loan. Also, Maine requires that the applicant take a ten-minute online loan counseling course.

Minimum and Maximum Loan Amounts

The maximum loan amount ranges from $70,000 in Minnesota to no maximum in Alaska, Massachusetts, and North Dakota. The next table summarizes minimum and maximum loan amounts for the state programs.

Table 1-4. Minimum and Maximum Loan Amounts, by State

State	Minimum Loan Amount	Maximum Loan Amount
Alaska	$7,500	Up to the cost of attendance
Connecticut	$5,000	$100,000
Iowa	$5,000	$150,000
Kentucky	$7,500	$150,000
Louisiana	$5,000	$150,000
Maine	$10,000	$240,000
Massachusetts	$10,000	None
Minnesota	$10,000	$70,000 for a bachelor and graduate degree; $25,000 for a certificate, diploma, or associate degree.
New Hampshire	$7,500	$200,000
North Dakota	None	None
Rhode Island	$7,500	$250,000
South Carolina	$10,000	$150,000

Source: State student loan authority websites located in Appendix A.

Interest Rates

A borrower's interest rate on a student loan varies based on credit score, credit history, loan term length, highest degree level of the primary borrower, and whether the borrower lives, works, or went to school in a state. Borrowers in some states may lower their interest rate by 0.25% to 0.50% by using a cosigner or signing up for auto-pay. Louisiana's loan authority will reduce a borrower's interest rate by 1.0% if a borrower makes consecutive monthly payments in full and on time (i.e., 24 consecutive payments for a 5-year repayment term). Borrowers from Alaska's loan authority can reduce their interest rate up to 0.50% by living in Alaska or attending school in Alaska. The next table summarizes the loan rates for each state's authority.

[13] Why Students With Smallest Debts Have the Larger Problem by Susan Dynarski, New York Times, August 31, 2015, available at https://www.nytimes.com/2015/09/01/upshot/why-students-with-smallest-debts-need-the-greatest-help.html?_r=0

Table 1-5. Student Loan Interest Rates, by State

State	Fixed Interest Rates	Variable Interest Rates
Alaska	5.20%	None
Connecticut	5.00%	None
Iowa	4.25% to 7.25% (residents); 4.50% to 7.50% (non-residents)	None
Kentucky	4.45% to 7.59%	None
Louisiana	5.5% to 8.55%	None
Maine	Varies by individual financial institution	Varies by individual financial institution
Massachusetts	4.95% to 6.85%	3.41% to 6.31%
Minnesota	4.25% to 6.75%	3.20% to 4.55%
New Hampshire	3.94% to 7.54%	2.56% to 6.16%
North Dakota	4.36%	2.35%
Rhode Island	3.49% to 7.64%	None
South Carolina	4.75% - 6.00%	None

Note: rates are as of December 2016.
Source: State student loan authority websites located in Appendix A.

Fees and Payment Options

Eleven of the twelve states studied do not charge fees for the application, origination, disbursement, or prepayment of the loan. North Dakota is the only state that charges a 3.75% administrative fee for non-residents. States do charge borrowers a fee for late payments. Borrowers typically make a monthly payment that includes loan principal and interest. Repayment lengths varies from five to 30 years. The next table summarizes options for loan repayment terms, by state.

Table 1-6. States' Repayment Term Length

States	Repayment Term Length
Alaska	5, 10, or 15 years
Connecticut	5, 10, or 15 years
Iowa	5, 10, or 15 years
Kentucky	10, 15, 20, or 25 years
Louisiana	5, 10, or 15 years
Maine	Varies by individual financial institution
Massachusetts	15 years
Minnesota	5, 10, or 15 years
New Hampshire	5, 10, 15, or 20 years
North Dakota	10, 15, 20, and 25 years
Rhode Island	5, 10, or 15 years
South Carolina	5, 10, or 15 years

Source: State student loan authority websites located in Appendix A.

While the federal government offers borrowers an income-driven repayment plan (typically 10% of a borrower's discretionary income), states do not offer a comparable option. The default levels for loan repayment in the states studied were relatively low. Approximately 2.0 to 2.5% of borrowers in Massachusetts default on their loans while North Dakota and Rhode Island have not had any refinancing defaults.

Loan Forgiveness

Iowa, Kentucky, Minnesota, New Hampshire, and Rhode Island provide loan forgiveness (the borrower doesn't have to pay back the remainder of the loan amount) if a borrower dies or becomes totally and permanently disabled. Only South Carolina offers a profession-based loan forgiveness program – for teachers. South Carolina's program is limited to student loans for teachers, not for loan refinancing.

In South Carolina, teachers who work in certain critical geographic areas and/or teach in a critical subject area in the South Carolina public school system can have their loans forgiven up to 33 1/3% or $5,000 annually (whichever is greater) for each full year of teaching. Alaska ended a teacher forgiveness program due to expense and because it did not meet its original goals. Many borrowers in Alaska left the teaching profession and defaulted on their student loans (losing eligibility for loan forgiveness).

The federal government has several loan forgiveness programs, summarized below.

- **Public Service Loan Forgiveness:** Federal loan balance will be forgiven if the borrower works full time for a non-profit or the government for at least ten years;

- **Teacher Loan Forgiveness:** Up to $17,500 in direct or Stafford loans will be forgiven if borrowers work full time as a teacher for five consecutive years, work in low-income public elementary or secondary schools, and took out their first loans after October 1, 1998;

- **Perkins Loan Cancellation:** Up to 100% of federal Perkins loans can be forgiven if borrowers work in public service jobs for five years or more; and

- **Income-Driven Repayment:** Federal loan balance will be forgiven after 20 or 25 years, depending on the loan.

All state refinancing authorities strongly encourage applicants to make sure the savings of refinancing federal loans outweigh the benefits (such as forgiveness) that borrowers forfeit by refinancing. Many state websites include detailed descriptions of possible benefits lost by loan refinancing – Minnesota has one of the more extensive lists.[14]

National Private Companies – Market Competition

Several private national companies compete directly with the state refinancing authorities. Some of the larger ones include SoFi (Social Finance), Citizens Bank, Earnest, iHELP Student Loans from Community Banks, Lend Key, Common Bond, and College Ave. These companies offer competitive interest rates that may be lower than state student loan refinancing authorities. As of December 2016, fixed interest rates from private lenders ranged from 3.25% to 7.74% (compared to 3.94% to 8.55% for public lenders) and variable rates ranged from

[14] Federal Benefits You Could Lose by Refinancing by the Minnesota Office of Higher Education, available at http://www.selfrefi.state.mn.us/refi_fed_benefit_implications.pdf

2.18% to 6.27% (compared to 2.35% to 6.31% for public lenders). Most private lenders do not have a maximum loan amount.

Private national companies advertise lower rates because they use risk-based pricing, advertising lower rates knowing that only a small portion of applicants will qualify for those rates. The remaining applicants will likely have higher rates compared to state loan authorities.[15] Risk-based pricing focuses on risk to lenders rather than on a borrower's risk or ability to pay.[16]

[15] What is risk-based pricing? By the Consumer Financial Protection Bureau, available at http://www.consumerfinance.gov/askcfpb/767/what-risk-based-pricing.html

[16] Paying the Price: the High Cost of Private Student Loans and the Dangers for Student Borrowers by the National Consumer Law Center, March 2008, Page 7, available at http://www.studentloanborrowerassistance.org/wp-content/uploads/2013/05/Report_PrivateLoans.pdf

CHAPTER 2. Startup and Operating Costs for State Programs

This chapter discusses the startup and operating costs for state student loan refinancing programs. Startup costs include the funding needed to provide necessary reserves for the initial loan program amount.[17] Operating costs include the funding and personnel needed to operate an ongoing program, including initial or one-time costs in the first year of implementation. Additionally, while no program studied required additional funding beyond the startup funding, it is possible that a refinancing program would need to be recapitalized. The likelihood of such an occurrence depends a large part on the policy goals of the program, discussed more in Chapter 5. This chapter is organized into three sections:

- **Section A,** Startup Costs and Initial Refinancing Loan Program Totals;
- **Section B,** Operating Costs; and
- **Section C,** Types of Financing/Bonds.

A. Startup Costs and Initial Refinancing Loan Program Totals

Research shows that a student loan refinancing program can be self-sustaining within three to ten years, depending on how much equity the program is putting aside (more equity put aside, the faster it can be self-sustaining). Representatives from Bank of America Merrill Lynch estimate that a student loan refinancing program would need approximately 10-15% of the program's total projected loans as startup funding, with smaller programs requiring a higher percentage due to fixed costs associated with refinancing programs. For example, a smaller $5 million program would need startup funding of $750,000 (15%) while a larger $50 million would need $5 million (10%).

The Montgomery County Department of Finance has estimated that a Montgomery County Student Loan Refinancing Authority would need $20 to $30 million to start a $100 million refinancing program. Finance stated that 20% to 30% in initial funding would "originate and accumulate a quality portfolio of student loans with the proper levels of overcollateralization, reserves, and excess spread before securitizing." Montgomery County estimates higher costs for startup funding because issuing new bonds that do not have a credit rating or a proven track record is typically more expensive for a jurisdiction. Louisiana also estimated it would need startup funding of 20%.

Startup funds for a Montgomery County Student Loan Refinancing Authority could come from several sources such as a one-time cash appropriation or taxable general obligation bonds. Startup funding from the County (to be paid back by the Student Loan Refinancing Authority) would impact the County's debt levels (the amount the County can borrow).

The next table summarizes the total loans issued by state refinancing authorities in their first and second years of operation. Amounts ranged from $4 million in Iowa to $194 million in North Dakota. Excluding the largest programs in Minnesota and North Dakota, states had an average of $7.5 million in loans in their first year of operations. Most programs use the first year for a "soft launch," with minimal or no advertising and marketing.

[17] Reserves serve as collateral, which are assets pledged as a recourse to a lender if a borrower defaults on an initial loan.

Table 2-1. Total First Year Loans by Refinancing Programs, by State

State	Total First Year Loan Amount	Total Second Year Loan Amount
Alaska	$15 million	No Limit
Connecticut	$5 million	TBD
Iowa	$4 million	$4 million
Louisiana	$5-6 million*	TBD
Minnesota	$100 million	$100 million
North Dakota	$194 million	$400 million
Rhode Island	$8 million	$27 million

**Planned for 2017*

Source: Interviews with state student loan authorities.

B. Operating Costs

This section describes the operating costs from three student loan refinancing programs with similarities to Montgomery County. Operating costs stem from numerous types of activities, including[18]:

- **Program Development**: Developing a plan for a viable loan product (e.g., rates and terms), market opportunities, and rollout plans.
- **Origination**: Accepting and processing loan applications and using the information to determine eligibility and interest rates.
- **Loan Servicing**: Collecting loan payments, responding to customer service inquiries, and performing other administrative tasks associated with a loan program.
- **Marketing**: Promoting a loan program through advertising, print media, electronic media, etc.
- **Collections**: Retrieving payments from borrowers that defaulted on their loans (have not made a payment for an extended period time, usually 270 to 360 days).
- **Compliance/Audit/Legal**: Ensure compliance with all applicable laws, rules, and regulations, including bond and underwriting counsels. Establishing a new student loan refinancing authority would require additional legal fees.
- **Bond Underwriting/Bond Issuance**: Services and fees associated with issuing government bonds.
- **Financial Advice**: Providing guidance to structure loan terms and pricing and perform cash flow projections.
- **Software**: Establishing a technology platform for a refinance program.

The states examined for this report each included a different mix of these services – provided either by government employees or through a contractor. Because the programs' operating costs often included the

[18] From interviews with state student loan authorities, StudentLoans.gov's glossary, available at https://studentloans.gov/myDirectLoan/glossary.action , and from the Consumer Financial Protection Bureau's "Ask CFPB," available at https://www.consumerfinance.gov/askcfpb/ . Items such as rent, furniture, computers, utilities, etc., were not included since they would vary based on the number of services a student loan refinancing authority contracts out.

operating costs for both a private student loan program *and* a refinancing program, OLO has limited the discussion of operating costs to three programs with characteristics similar to Montgomery County. They are:

1. **Rhode Island:** Similar in population to Montgomery County (1.040 million residents in Montgomery County and 1.056 million residents in Rhode Island).[19]

2. **Louisiana:** Currently starting a refinancing program; no active private student loan program.

3. **Connecticut:** Representatives from multiple state authorities and Bank of America Merrill Lynch recommended Connecticut as a possible model for Montgomery County.

<u>Rhode Island</u>

The Rhode Island Student Loan Authority (RISLA) currently provides a student loan program of $384.0 million – $357.0 million in student loans and $27.0 million in refinanced student loans. For the fiscal year ending on June 30, 2017, RISLA projects disbursement of $50.0 million in student loans and $20.0 million in refinanced student loans. RISLA employs in-house staff with a loan department of nine FTEs: a director, one manager, three originators, and four loan servicing representatives. The next table summarizes the primary annual operating costs for RISLA.

Table 2-2. RISLA Total Annual Operating Costs

Service	Annual Cost
Employee Salaries	$500,000
Lease for Loan Servicing Platform/Software	$528,000
Total	**$1,028,000**

Source: RISLA data

<u>Louisiana</u>

The Louisiana Education Loan Authority (LELA) recently started its student loan refinance program and estimates loan refinancing volume between $5,000,000 and $6,000,000 in its first year. LELA is currently using 10.5 existing FTEs ($725,000) from the Louisiana Public Facilities Authority federal loan division to launch the program while contracting for services related to the startup. LELA will determine its ongoing annual operating costs after the first year of implementation. The next table summarizes the initial operating costs.

[19] US Census Population estimates from 2016 and 2016; Montgomery County available at http://www.census.gov/quickfacts/table/PST045215/24031 and Rhode Island available at http://www.census.gov/quickfacts/table/PST045216/44

Table 2-3. Louisiana Education Loan Authority's Initial Refinancing Operating Costs

Service	Estimated Cost
Program Development	$25,000
Origination	Fee Per Completed Application
Loan Servicing – Set-Up	$20,000 - $25,000
Loan Servicing - Ongoing	Fee Per Account
Marketing	$25,000 - $50,000
Compliance/Audit	$5,000 - $10,000
Legal Fees	$10,000
Financial Advisor	$45,000
Miscellaneous (software/admin. svcs.)	$10,000

Source: LELA data

Connecticut

The Connecticut Higher Education Supplemental Loan Authority (CHESLA) has a $130.3 million student loan program – $119.3 million in student loans and $5.5 million in refinanced student loans in a first-year pilot. As of January 2017, CHESLA has $1.7 million available to lend for student loans and $3.8 million for refinanced student loans. CHESLA employs a small staff for both loan programs and relies heavily on contractor services. CHESLA's Executive Director (ED) is the ED of the Connecticut Health and Educational Facilities Authority (a quasi-public company). The ED also manages CHESLA under a management agreement between the two organizations, with no salary and benefits paid by CHESLA. CHESLA also employs a Deputy Director and an Assistant Director). The next table summarizes CHESLA's startup costs and projected annual operating costs.

Table 2-4. CHESLA Operating Costs

Service	Annual Budget
Startup Costs	
Program Development/Planning	$71,000
Initial Contracted Program Services	$329,000
Total	**$400,000**
Ongoing Annual Operating Costs	
Employee Salaries	$208,000
Contracted Program Services	$500,000
Total	**$779,000**

Source: CHESLA data

C. Types of Financing/Bonds

Until recently, state student loan authorities could only use taxable bonds for a refinancing loan program. That changed in November 2015 when the Internal Revenue Service (IRS) issued Notice 2015-78, allowing student loan authorities to use tax-exempt bonds for refinancing and for parent-student loans.[20] Previously, tax-exempt bonds could only be issued to fund private student loans that met the nexus requirement (borrower was a resident of the state or went to an approved school within the state). The new IRS notice on tax-exempt bonds requires borrowers to meet state nexus requirements at the time of the original loan or at the time refinancing.

This change renders the interest an investor receives from tax-exempt bonds free from federal and, in most cases, local income taxes. Tax exempt bonds are considered a stable investment because the investor is guaranteed to get back their principal and interest.[21] More importantly, state student loan authorities have indicated that they receive better interest rates with tax-exempt financing.

Student loan refinancing authorities often use revenue bonds or general obligations bonds.

- **Revenue Bonds**: Most commonly used, a municipal bond supported by the revenue from a specific project or program, such as a toll bridge, a sewer system, a highway, a local stadium, or student loans. Revenue bonds are guaranteed by the specific revenue streams created by the project they financed. State student loan refinancing authorities also provide a "moral obligation," an additional moral pledge of commitment against default.[22]

- **General Obligation Bonds**: A municipal bond guaranteed by the credit and taxing power of the issuing jurisdiction. General obligation bonds are used for public projects that will serve a community, such as roads, parks, equipment, and bridges.[23] The Texas Higher Education Coordinating Board is the most prominent issuer of general obligation bonds for student loans.

The County Department of Finance has also indicated that tax-exempt private activity bonds could be used to fund a student loan refinancing authority.

- **Private Activity Bonds**: A type of revenue bond issued on behalf of a local or state government to provide special financing benefits for qualified projects. The financing or backing of these projects are usually from a private user/investment (government does not pledge its credit), but the projects provide some public benefit. Private activity bonds often are used for projects such as manufacturing plants, airports, or docks.[24]

The State of Maryland has allocated approximately $15.5 million to Montgomery County in 2017 for private activity bonds. The County may have to request additional PABs from the state to establish a student loan refinancing program. States that provide student loans or refinancing student loans that do not meet the state nexus requirement must issue taxable bonds for student loan financing.

[20] Notice 2015-78, Qualified Student Loan Bonds, by the Internal Revenue Service, available at https://www.irs.gov/pub/irs-drop/n-15-078.pdf
[21] Municipal Bonds, by the US Securities and Exchange Commission, available at https://www.investor.gov/introduction-investing/basics/investment-products/municipal-bonds
[22] Term from Investopedia, available at http://www.investopedia.com/
[23] Ibid.
[24] Ibid.

CHAPTER 3. Student Loan Figures and Determining Demand

This chapter reviews national and local student loan data and describes options for determining the demand for these services. It is organized into three sections.

- **Section A,** Student Loan Data Nationally and in Maryland;
- **Section B,** Student Loan Data for Montgomery County; and
- **Section C,** Demand and Professional Guidance.

A. Student Loan Data Nationally and in Maryland

Student loan debt in the United States has reached $1.28 trillion – 44.2 million Americans have an average monthly payment of $351 and a median monthly payment of $203.[25] An estimated $242 billion of this debt is eligible for refinancing.[26]

The most recent Maryland state data – including only recent graduates – comes from the Institute for College Access and Success's "Student Debt and the Class of 2015 (October 2016)." Among the schools that participated in the report, graduates' average student loan debt was $27,672 (national average is $30,100) and 56% of graduates left school with debt (national average is 68%).[27] Maryland ranked 28th highest in the country for average debt and 36th highest for percentage of graduates with debt.[28]

Overall, Maryland's education loan market is the 24th largest and it is dominated by federal student loans.[29] Over $1.1 billion Federal Stafford loans and $317 million Federal PLUS loans were originated for students attending Maryland schools in 2014-15.[30] Private student loans, which are more difficult to track than Federal loans, made up about 19% of student loans nationally for the class of 2015.[31] Nineteen percent of private student loans in Maryland would equate to $269 million.

B. Student Loan Data for Montgomery County

While student loan data at the county level is challenging to find, the Mapping Student Debt project by the Washington Center for Equitable Growth has compiled some data using credit reporting data on student debt

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[25] A Look at the Shocking Student Loan debt Statistics for 2017 by Student Loan Hero, February 8, 2017, available at https://studentloanhero.com/student-loan-debt-statistics/
[26] 2016 Credible Student Loan Refinancing Report, November 2016, Page 1, available at https://www.credible.com/blog/wp-content/uploads/2016/11/2016_credible_student_loan_refinancing_report.pdf
[27] Student Debt and the Class of 2015 by the Institute for College Access and Success, October 2016, Pages 1 and 5, available at http://ticas.org/sites/default/files/pub_files/classof2015.pdf
[28] Ibid., Page 5
[29] Montgomery County's Education Loan Refinance Program by Bank of America Merrill Lynch; data from the US Department of Education, May 2016
[30] Ibid.
[31] A Look at the Shocking Student Loan debt Statistics for 2017 by Student Loan Hero, February 8, 2017, available at https://studentloanhero.com/student-loan-debt-statistics/

from Experian and income data from the American Community Survey.[32] Mapping Student Debt compared data on average household student loan balances and delinquency to median income data at the zip-code level. When the project's interactive map is narrowed down to only the zip codes within Montgomery County, it provides a view of average student loan balances and delinquency rates compared to income levels.

Average Student Loan Balance

Mapping Student Debt project created a 10-level scale for comparing average student loan balance. Based on the national average for student debt, an "Average" rating means that an area's average student loan debt is between 10% lower and 10% higher than the national average. Seven of the ten levels measure average student loan debt above the national average while two measure debt below that level. The highest level on the scale, "Astronomical," means that an area's average student loan debt is 100% to 724% *higher* than the national average student loan debt. Conversely, a rating of "Low" means an area's average debt is 30% to 100% *below* the national average. The next table summarizes Mapping Student Debt's rating scale.

Table 3-1. Mapping Student Debt's Rating Scale for Average Student Loan Debt

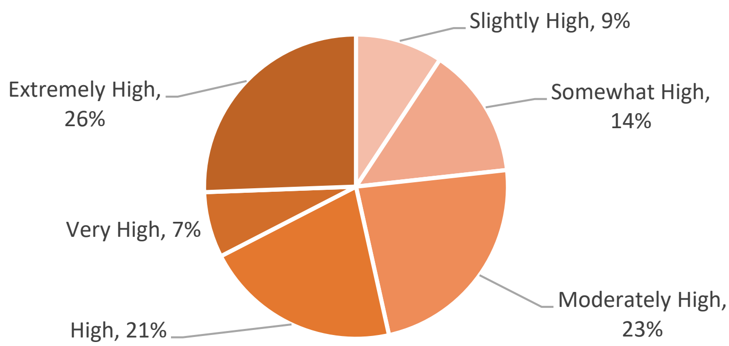
Rating	Compared to Average National Student Loan Debt
Astronomical	100% to 724%
Extremely High	65% to 100%
Very High	55% to 65%
High	45% to 55%
Moderately High	35% to 45%
Somewhat High	25% to 35%
Slightly High	10% to 25%
Average	**-10% to 10%**
Moderately Low	-30% to -10%
Low	-100% to -30%

Source: Mapping Student Debt by the Washington Center for Equitable Growth, available at http://www.mappingstudentdebt.org/#/map-1-an-introduction

The average student loan debt in Montgomery County's zip codes all fell into the category of "Slightly High" or above. Overall, the average student loans by zip code in the County ranged from 25% to 100% above the national average. The average balance was "Very High" or "Extremely High" in 33% of all zip codes in the County, included: Ashton, Bethesda, Chevy Chase, Brinklow, Cabin John, Garrett Park, Kensington, North Bethesda, Potomac, Rockville, Sandy Spring, Silver Spring, and West Bethesda. The next chart summarizes the percentage of Montgomery County zip codes that fall into each rating category.

[32] Mapping Student Debt by the Washington Center for Equitable Growth, available at http://www.mappingstudentdebt.org/#/map-1-an-introduction

Chart 3-1. Distribution of Zip Codes in Montgomery County, by Average Student Loan Balance

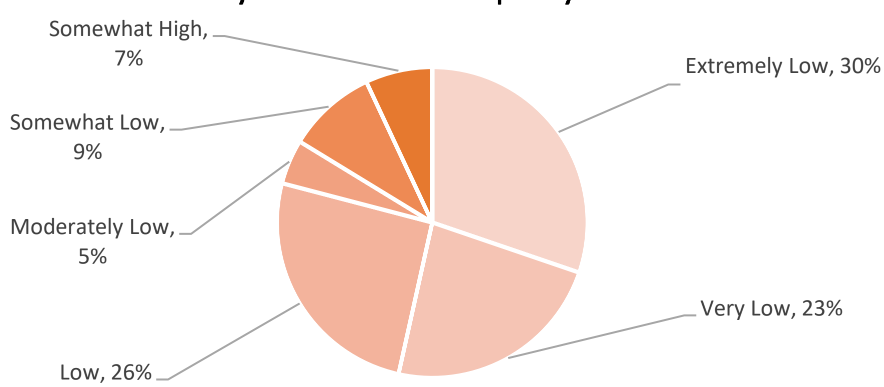


Student Loan Delinquency

The Mapping Student Debt project created a similar scale for student loan delinquency, in which a borrower is late on a payment. It calculated a delinquency rate for each zip code by dividing the average number of 90-or-more days-delinquent loans per household by the average number of outstanding loans per household. It then projected the delinquency rate to a 10-point scale ranging from "Extremely Low" to "Extremely High".

Overall, student loan delinquency in Montgomery County is relatively low. Delinquency ranged from "Extremely Low" to "Somewhat Low" in 93% of County zip codes. The 7% of the zip codes with "Somewhat High" (level 6 on the 10-point scale) student loan delinquency rates are in: Aspen Hill, Gaithersburg, Montgomery Village, and Silver Spring. The next chart summarizes these data.

Chart 3-2. Distribution of Zip Codes in Montgomery County, by Student Loan Delinquency Level



Median Household Income with Average Student Loan Balances and Delinquencies

In 2013, US Census data shows that the national median household income was $52,250.[33] Mapping Student Debt found that the household incomes in Montgomery County zip codes in the same timeframe ranged from $54,917 (Beallsville) to $192,891 (Cabin John) – all above the national average.

[33] Household income: 2013 by Amanda Noss, US Census Bureau, September 2014, available at http://www.census.gov/library/publications/2014/acs/acsbr13-02.html

Areas in the County with higher median incomes had lower delinquency rates, including areas with high average loan balances. This group tends to include undergraduate and graduate borrowers with higher earnings, low rates of unemployment, and greater family resources.[34] Areas with higher average loan balances and lower median household incomes had higher delinquency rates.[35] Montgomery County did not have any zip codes with both low median income levels *and* low average loan balances. This group often includes students who attended a two-or four-year college without earning a degree who may struggle to find well-paying work and include the borrowers who are most likely to be delinquent.

C. Demand and Professional Guidance

Data in the previous section indicates that there appears to be demand for student loan refinancing, based on the propensity of student loans in Montgomery County. However, the full extent of the demand for a student loan refinancing authority cannot be accurately determined until key program characteristics are set, such as residency requirements, minimum credit score/credit history requirements, minimum/maximum loan amounts, interest rates, fees, and forgiveness options. Additionally, other policy-specific goals – such as targeting the program at businesses, government entities, teachers, or homebuyers – would impact demand; these are discussed in Chapter 5. OLO recommends identifying core program characteristics first and then performing a professional market study and a loan product development plan to accurately determine demand.

Representatives from the state authorities interviewed for this project reported that demand was difficult to determine due to limited publicly available data. Most of the authorities hired a program development consultant – MeasureOne – to identify a viable loan product (rates and terms to use), market opportunities, and rollout plans. Other consultants who conduct this type of research include Goal Structured Solutions (GS2), Education Solution Partners, and SL Capital Strategies.

The County could also estimate one segment of demand by administering a survey of Montgomery County government employees and Montgomery County Public School (MCPS) Employees. The Montgomery County Education Association conducted a self-selected teacher survey in 2015 regarding student loan debt and 800 individuals responded (6.7% response rate[36]), with the following results:

- 50% had student debt of $40,000 upon completion of school;
- 61% still have more than $20,000 in student debt;
- This group's median income was $65,000;
- 32% had monthly payments of $400 or more; and
- 65% said they did not know what their monthly payments would be when they signed their loans.[37]

[34] A crisis in student loans? How changes in the characteristic of borrowers and in the institutions they attended contributed to rising loan defaults by Adam Looney and Constantine Yannelis, Brookings Papers on Economic Activity, September 2015, Page 4, available at https://www.brookings.edu/wp-content/uploads/2016/07/ConferenceDraft_LooneyYannelis_StudentLoanDefaults.pdf

[35] Why Students With Smallest Debts Have the Larger Problem by Susan Dynarski, New York Times, August 31, 2015, available at https://www.nytimes.com/2015/09/01/upshot/why-students-with-smallest-debts-need-the-greatest-help.html?_r=0

[36] MCEA sent the survey to approximately 12,000 MCEA teachers in 2015 for a response rate of 4.5%.

[37] Act Now! To Support MCEA's Student Debt Refinancing Bill, by the Montgomery County Education Association, February 25, 2016, available at http://mceanea.org/news/act-now-to-support-mceas-student-debt-refinancing-bill/

CHAPTER 4. Feasibility of Implementing a Student Loan Refinancing Authority

This chapter discusses the feasibility of establishing a student loan refinancing authority in Montgomery County and is organized into two sections.

- **Section A,** Legal Requirements; and
- **Section B,** Program Requirements.

A. Legal Requirements

Maryland House Bill 1079, providing the legal authority for the County to establish a student loan refinancing authority, includes several requirements that the County must meet in order to establish an authority, including:

- Study certain aspects of implementing an authority, including (1) performing a feasibility and demand[38] study, (2) assessing how an authority would impact recruitment and retention of County and school system employees, and (3) studying similar programs and operating costs of other authorities.
- Hold public hearings, and
- Provide opportunity for public comment.[39]

The Council would need to enact legislation to establish a refinancing authority.[40] This report satisfies House Bill 1079's study requirement. However, the Council can engage an outside contractor to perform a loan product development plan and more detailed market study, which cannot be done without information on specific program characteristics such as residency requirements, credit history, maximum loan amounts, and interest rates. If the Council introduces legislation to establish a refinancing authority, the process would include public hearings and provide an opportunity for public comment, satisfying those requirements. House Bill 1079 also requires the Montgomery County Office of Intergovernmental Relations to notify the State's Department of Legislative Services (DLS) within 10 days if the Council enacts legislation to establish an authority. The County has until June 30, 2019 to notify DLS.

B. Program Requirements

Based on the review of state student loan programs, research, and interviews with finance professionals, establishing a County student loan refinancing program would require:

- Identifying program characteristics and a market for student loan refinancing.
- Financial resources, including startup costs, operating costs (initial and ongoing), a projection of revenue expectations, and the ability to issue bonds (already granted to an establishing authority by the state enabling legislation).
- Qualified staff and/or contractors.
- Physical office space and resources.

[38] The Council will need to engage an outside consultant to perform a demand study.
[39] 2016 Laws of Maryland, Chapter 296 (House Bill 1079), Montgomery County Student Loan Refinancing Authority, available at http://mgaleg.maryland.gov/2016RS/chapters_noln/Ch_296_hb1079T.pdf
[40] Ibid.

C. Montgomery County Revenue Authority

Representatives of the Montgomery County Revenue Authority have expressed interest in administering a student loan refinancing program in the County if the Council chooses to establish one. The County could establish a relationship like Connecticut's, where the executive director of the Connecticut Health and Educational Facilities Authority (CHESLA) is also executive director of the Connecticut Higher Education Supplemental Loan Authority.[41]

The Revenue Authority is an instrumentality of Montgomery County and a public corporation created in 1957 to construct and operate a variety of self-supporting projects.[42] Current self-supporting projects include the Montgomery County Airpark and golf courses. For these projects and others, the Revenue Authority has years of experience issuing taxable and non-taxable bonds. This experience could make the Revenue Authority an effective match to operate a student loan refinancing program.

[41] The Executive Director (ED) manages CHESLA and the Connecticut Health and Educational Facilities Authority (CHEFA) through a management agreement in which the ED's salary is paid exclusively by CHEFA.
[42] Montgomery County Revenue Authority description, available at http://www.mcra-md.com/

CHAPTER 5. Policy Considerations when Establishing a Student Loan Refinancing Program

While all student loan programs have at their core the goal of reducing or making student loan debt more affordable, program eligibility requirements can target programs to specific groups of student loan holders if policymakers seek to fulfill a specific public policy goal. Previous chapters have focused on whether it is feasible for Montgomery County to implement a student loan program and whether demand exists in the County for this type of program. This chapter examines public policy questions and goals that the Council can consider in its discussion of whether to implement a student loan refinancing authority in the County. It is organized into six sections: Section A describes relevant policy questions and Sections B-F describe different public policy goals that student loan refinancing programs can address.

- **Section A,** Public Policy Considerations;
- **Section B,** Assisting Students with Debt and/or College Access;
- **Section C,** Recruiting and Retaining County Professionals;
- **Section D,** Targeting Specific Low Income or Disadvantaged Groups;
- **Section E,** Encouraging Increased Home Ownership; and
- **Section F,** Existing Programs Addressing Student Loan Debt in Maryland

A. Public Policy Considerations

Chapter 2 provided an overview of the program characteristics typical of state student loan refinancing programs. These characteristics center around who is eligible for a program and can be divided into two general categories: (1) technical characteristics such as credit scores, amount of debt, interest rates, and applicant income levels and residency status; and (2) eligibility based on desired public policy goals. Some programs are configured broadly to reduce or make college loan debt more affordable for a wide swath of loan holders. Others are tailored to achieve a specific goal or help a specific group of loan holders. These two topics are discussed in more detail below.

<u>Technical Student Loan Refinancing Authority Characteristics</u>
The eligibility requirements that a loan refinancing program establishes determines how "credit-worthy" borrowers need to be and what level of risk a loan refinancing program is willing to take on. The more stringent the credit requirements are, the lower the risk that borrowers will default. However, rigorous credit requirements limit eligible borrowers including groups of borrowers most likely to benefit from loan refinancing (e.g., low income borrowers without a completed degree).

Other central program characteristics, which will dictate the size of a program, include minimum and maximum loan amounts, fees, and payment options. Programs that offer higher loan amounts cater to borrowers with post-graduate degrees, who typically have a lower rate of default. Borrowers with smaller loan amounts typically have higher default rates. Most state programs have minimal fees and multiple payment options to compete with private, national companies. The next table summarizes questions for Council consideration.

Table 5-1. Questions Related to Establishing a Loan Refinancing Program, by Characteristic

Residency	Open only to County residents? Maryland residents? Out-of-State residents attending a school in Montgomery County (e.g., Montgomery College)?
Employment/Income	Employment required? Minimum income? Both?
Credit	Minimum FICO score? Effect of previous loan delinquencies or bankruptcies? Maximum debt-to-income ratio?
Degree	Does borrower have to have a completed degree? Two-year and/or four-year programs? Eligibility of certificate programs?
Loan Amount	What will the minimum and maximum loan amount be? As high as the cost of school attendance?
Fees and Payment Options	Will there be any fees, such as an application fee? Will the payment terms be for 15 years? 20 years?
Interest Rate	Market rate interest? Lower rates to provide an incentive not offered by other lenders?

Policy Goals

Just as key program characteristics can determine who can participate in a loan refinancing program, policy makers can identify policy goals for a program and shape a program to meet those goals. In general, student loan refinancing programs are intended to reduce student debt or make debt more affordable on a month-to-month basis.

Government-sponsored student loan refinancing programs typically, although not always, are available to residents of the jurisdiction implementing the program and those who attended a school physically located in that jurisdiction. Policy makers may choose to further limit eligible participants to advance other, more specific policy objectives. Some examples of policy considerations are listed below (this is not an inclusive list of all potential policy considerations):

Assisting Students with Debt and/or College Access	Program proceeds can go towards helping existing students. For example, proceeds of the Texas Higher Education Coordinating Board's bonds are used to make low interest loans to students in undergraduate, graduate, and professional education programs at Texas public or private colleges and universities. Other state programs help with college access (include grants) and financial literacy.
Recruiting and Retaining County Professionals	Interest rate reductions and/or loan forgiveness targeted to certain professions such as teachers, police, firefighters, county government employees, etc., can help with recruitment and retention.
Targeting Specific Low Income or Disadvantaged Groups	Examples include "first-in-family" students who are the first ones to go to college; low-income families who have difficulty meeting minimum loan income requirements; and students from disadvantaged backgrounds.
Encouraging Increased Home Ownership	Programs can target first-time (or other) home buyers in a particular jurisdiction. Augmenting Montgomery County's first time homebuyer credit program with the ability to refinance student loans could encourage new homebuyers to choose Montgomery County over other local jurisdictions such as Fairfax County and Washington, DC.

B. Assisting Students with Debt and/or College Access

The Texas Higher Education Coordinating Board (THECB) has a clear focus on assisting students with college access, student debt, and higher education success. In 2015, THECB set out a higher education strategic plan that includes four goals: (1) increasing the overall educational attainment among younger adults, (2) achieving more student degree/certificates that reflect the state's changing demographics, (3) ensuring that students gain marketable skills they can articulate to employers, and (4) holding student debt to its current level for students who graduate with debt from Texas public two- and four-year institutions.[43] Outside of the traditional student loan, THECB offers the following programs to help with college access and student debt:

- **Texas B-On-Time:** a zero-interest loan up to $8,722 per year for four-year institutions; eligible students must be eligible to receive federal financial aid, complete 75% of the semester credit hours attempted in the most recent academic year, and have a cumulative GPA of at least 2.5 on a 4.0 scale; forgiveness may be granted if a student meets certain academic requirements.[44]

- **Texas Armed Services Scholarship Program:** covers $7,000 or up to a student's cost of attendance minus the student's income for an academic year (up to four years); encourages students to join the Texas or US military and requires training and service once a degree is completed; awardees are appointed by the governor, lieutenant governor, state senators, and state representatives.

Similarly, a County refinancing student loan authority could seek to help reduce student debt at the start of a student's college experience. Research shows that the students that start making interest payments earlier can prevent a "snowball effect" of deferred interest payments during school.[45] A County program could help students make interest payments while in school and lessen their loan burden when they leave school.

A County authority could also include programs and/or outreach to help students with college access. College Possible, for example, helps students fill out Free Application for Federal Student Aid (FAFSA) forms, college applications, and transition to college. It also provides college campus tours, spearheads community service projects, and supports students once they have entered higher education institutions.[46]

C. Recruiting and Retaining County Professionals

Some student loan authorities partner with businesses to help recruit and retain employees. North Dakota, Rhode Island, and Iowa have launched programs.

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[43] 60x30TX Progress Report, by the Texas Higher Education Coordinating Board, September 2016, available at http://www.thecb.state.tx.us/reports/PDF/9136.PDF?CFID=59703700&CFTOKEN=20267164

[44] Texas B-On-Time (BOT) Loan Program, by the Texas Higher Education Coordinating Board, available at http://www.hhloans.com/index.cfm?objectid=B00C090D-E45D-4F4B-89DA195959930185

[45] How Paying Student Loan Interest in College Pays Off, by Elizabeth Renter, US News & World Report, January 9, 2015, available at http://money.usnews.com/money/blogs/my-money/2015/01/09/how-paying-student-loan-interest-in-college-pays-off

[46] At 5 city schools, program makes "College Possible," by Ryanne Persinger, The Philadelphia Tribune, April 29, 2017, available at http://www.phillytrib.com/news/at-city-schools-program-makes-college-possible/article_49376ab3-1a40-56c6-b91b-2bafdb4f94c8.html

The North Dakota Bank works with Microsoft, one of North Dakota's largest employers, by giving presentations on the benefits of refinancing to employees at Microsoft's Fargo campus. Microsoft, in term, promotes to prospective and current employees the benefits provided by the Bank's refinancing program.

Microsoft sees the partnership as a valuable recruiting and retention tool – especially because over 51 percent of Microsoft's hires in North Dakota come from states other than North Dakota.[47] Other businesses have established the same type of no-cost relationship with the Bank of North Dakota. The Bank has worked with realtors, engineering firms, the State Bar Association of North Dakota, the health care industry, manufacturers, schools, and economic development groups.

The Rhode Island Student Loan Authority's (RISLA) similarly partners with businesses. RISLA also offers one-on-one counseling and a free online employee portal/tool for all types of student loans (including private and federal). RISLA's Chief Financial Officer reports that RISLA approaches student loans from the perspective of what is best for the individual – not what is best for sales. RISLA's programming:

- Helps employees gather and organize student loan information.
- Counsels employees on payoff strategies, refinancing, consolidation, and income-driven repayment plans.
- Educates employees about loan forgiveness programs they may qualify for.
- Helps employees determine the best course of action for achieving their goals.[48]

RISLA started partnering with businesses in September 2016. Although not linked to loan refinancing, RISLA also runs the bRIdge.jobs internship program, which links interested Rhode Island businesses and students.

Iowa Student Loan's business partnerships provide services similar to North Dakota's and Rhode Island's with additional components to help businesses with employee retention and recruitment:

- Employee borrowers who sign up receive a 0.35% interest rate reduction (greater than the standard 0.25% reduction for automatic withdrawal).
- Employee borrowers can receive up to an additional 0.50% interest rate reduction for being in a profession with an historically good track record for paying back loans (based on FICO scores). Iowa Student Loan focuses on science, technology, engineering, and math (STEM) professions.
- Iowa Student Loan can process payments made by a business toward an employee's student loan(s).

Research did not find any authorities currently partnering with government entities but nothing would preclude a refinancing authority from establishing such a partnership.

Some private companies are providing funding towards student loans – similar to retirement contributions – as a tool for recruitment and retention. Companies such as Fidelity, PricewaterhouseCoopers, Aetna, and Staples

[47] ND Student Loan Refinance Program Helping Businesses Recruit Workers, by Patrick Springer, Inforum, July 3, 2016, available at http://www.inforum.com/news/4066313-nd-student-loan-refinance-program-helping-businesses-recruit-workers

[48] Student Loan Repayment Solutions for Employees, by the Rhode Island Student Loan Authority, available at https://info.risla.com/employee-assistance

provide annual student loan contributions from $1,000 to $6,000.[49] Only about four percent of companies offer this relatively new benefit.[50]

While none of the student loan refinancing authorities studied have a program specifically targeting teachers, South Carolina Student Loan (SCSL) does provide student loans to future teachers that includes loan forgiveness for working in a critical geographic area or subject area (*see Chapter 1, page 9*). Other states and the federal government have teacher loan forgiveness programs, including Arkansas, Illinois, Iowa, Maine, Maryland (*see Section F*), Mississippi, and Texas.[51] Like South Carolina, these programs require that the teachers work in a critical geographic area (usually low income) or subject. A student loan refinancing authority could similarly target services/benefits to teachers.

D. Targeting Specific Low-Income or Disadvantaged Groups

Between 2008 and 2015, the percentage of students from low-income families enrolling in higher education immediately after graduating from high school declined by 10 percentage points, from 56 percent of graduates to 46 percent.[52] Furthermore, only eight percent of low-income students graduate college by the age of 25.[53] Low-income parents also are more likely to *overestimate* the cost of college compared to other groups of parents, which can impact school choice options for their children[54] if they are not aware of financial aid opportunities.

Some states have programs and grants to assist low-income students. CalGrants in California assists students with the financial aid process and offers need-based grants.[55] Wisconsin offers several programs targeting low-income and disadvantaged students:

- **Wisconsin Higher Education Grants:** serve low income residents who are enrolled at least half-time in undergraduate programs at Wisconsin State Universities and Technical Colleges.

- **Wisconsin Tuition Grants:** aid students with financial needs attending independent colleges and universities within the state; the program attempts to bridge the gap between the cost of public and private school tuition, by extending grants to private school students.

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[49] Student Loan Repayment: The Hottest Employee Benefit of 2017, by Zack Friedman, Forbes, December 19, 2016, available at https://www.forbes.com/sites/zackfriedman/2016/12/19/student-loan-repayment-benefit/#55e2ff311d6f
[50] Ibid
[51] The Complete Guide to Student Loan Forgiveness for Teachers, by Kat Tretina, Student Loan Hero, available at https://studentloanhero.com/featured/student-loan-forgiveness-for-teachers/
[52] Where Have All the Low-Income Students Gone?, by Higher Education Today, November 25, 2015, available at http://www.higheredtoday.org/2015/11/25/where-have-all-the-low-income-students-gone/
[53] What It's Like to Be the First Person in Your Family to Go to College, by Liz Riggs, the Atlantic, available at https://www.theatlantic.com/education/archive/2014/01/what-its-like-to-be-the-first-person-in-your-family-to-go-to-college/282999/
[54] Low-Income Families Disproportionately Face Obstacles in College Decisions, by Brittany Hackett,
[55] Low Income or Bad Credit Education Grants, by College Scholarships.org, available at http://www.collegescholarships.org/grants/low-income.htm

- **Talent Incentive Program:** supports Wisconsin students with the highest levels of financial need and educational dysfunction. Students are recommended for these grants by financial aid offices and counselors in the Wisconsin Educational Opportunities Program.[56]

A student loan refinancing authority could establish similar programs and/or grants, including need-based grants or no-interest loans (noted in Section B). Programs can also offer support for these students to help them prepare for, apply to, and succeed in college.

E. Encouraging Increased Home Ownership

Since the financial crisis of 2008, 27-30 year-old student loan borrowers steadily retreated from the housing market – more so than the same age group *without* student loan debt.[57] Additionally, 41% of borrowers with student loans in general have postponed buying a house or an apartment.[58] While there can also be a number of other factors contributing to the decline – even a cultural shift of delaying a home purchase – refinancing student loans can provide a borrower with more liquid assets to save or pay for a mortgage.

Home ownership, in general, also has declined over the past several years.[59] Several factors likely have contributed to the decline, such as increased lending standards for mortgages, low credit scores, high debt balances, and a lack of liquid assets.[60] The average student loan borrower has taken on increased debt since the financial crisis – with the average student loan balance increasing from $23,200 for the Class of 2008 to $30,100 for the Class of 2015, an almost 30 percent increase.[61]

Just like a low debt-to-income ratio is a factor when refinancing a student loan, it is also a factor when applying for a mortgage. Excessive debt-to-income ratios account for nearly a quarter of all mortgage denials.[62] Refinancing a student loan can lower a borrower's debt-to-income ratios in several ways, such as reducing the interest rate while keeping the same term length for the loan or increasing the term length with a similar interest rate. However, the second method – increasing the term length and *not* adjusting the rate – will have a borrower pay more in the long term, as illustrated by the next example from the Finance Authority of Maine.

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[56] Ibid

[57] Just Released: Young Student Loan Borrowers Remained on the Sidelines of the Housing Market in 2013, by Meta Brown, Syndnee Caldwell, and Sarah Sutherland, Liberty Street Economics, May 13, 2014, available at http://libertystreeteconomics.newyorkfed.org/2014/05/just-released-young-student-loan-borrowers-remained-on-the-sidelines-of-the-housing-market-in-2013.html

[58] 2015 Student Loan Burden Report

[59] The Effects of Mortgage Credit Availability: Evidence from Minimum Credit Score Lending Rules, by Steven Laufer and Andrew Paciorek, Federal Reserve Board, 2016, Page 1, available at https://www.federalreserve.gov/econresdata/feds/2016/files/2016098pap.pdf

[60] Ibid., Page 1

[61] Project on Student Debt by the Institute for College Access & Success; Class of 2008 figure, Page 2, available at http://ticas.org/sites/default/files/pub_files/classof2008.pdf ; Class of 2015 figure, Page 4, available at http://ticas.org/sites/default/files/pub_files/classof2015.pdf

[62] How the Government's Student Loan Repayment Programs Can Trip Up Homebuyers, by Stephen Dash, Forbes, January 3, 2017, available at https://www.forbes.com/sites/stephendash/2017/01/03/how-the-governments-student-loan-repayment-programs-can-trip-up-homebuyers/#62aec40d2f37

Table 5-2. Finance Authority of Maine Refinancing Example – Increasing Term Length[63]

Current Loan Balance	$30,254	
Current Interest Rate	5%	

Time Until Payoff	5 Years	10 Years
Monthly Payment	$571	$321
Total Payments	$34,260	$38,520

Savings of Lower Monthly Payment	$250
Cost of Additional Payments over Five Years	**$4,260**

Source: Finance Authority of Maine

Although the monthly payment would be $250 lower under a 10-year term compared to a 5-year term, a borrower would pay $4,260 more over the 10-year term. Borrowers, however, would have a lower debt-to-income ratio, which can increase the likelihood of being approved for a mortgage.

F. Existing Programs Addressing Student Loan Debt in Maryland

Maryland has four prominent existing programs that address student loan debt state-wide:

1. **Maryland SmartBuy**: If a buyer has at least 5 percent for a down payment for a house, the State of Maryland will provide up to 15 percent of the purchase price toward outstanding student loans.[64] However, the buyer/borrower will have to pay off the remaining student loan balance by the closing date for the house purchase. This program is only available for selected real estate owned properties (foreclosures), with the majority of the properties listed in Baltimore and Prince George's County.

2. **Janet L. Hoffman Loan Assistance Repayment Program (LARP)**: For Maryland residents who earned a degree or certificate from a college/university in Maryland and are employed full-time (up to $60,000 gross salary; $75,000 for a nurse faculty member) by a state or local government or non-profit in Maryland that serves low income, underserved residents or underserved areas in the state.[65] Total awards range from $4,500 to $30,000; award amounts are determined by reported educational debt and priorities are given to recent graduates, priority employment fields (legal services and nursing), and priority teaching areas (federal Title I schools, schools identified for improvement, or critical shortage subject fields).[66]

   The Nancy Grasmick Teacher Award: A subcategory of LARP; applicants must meet the requirements from LARP, have taught in Maryland for the past two years, and must:

[63] Available at http://www.theloanforme.com/wp-content/uploads/2016/05/LoanForME_refinancing.pdf
[64] Maryland SmartBuy, by the Department of Housing and Community Development, available at http://mmp.maryland.gov/Pages/SmartBuy/default.aspx
[65] Janet L. Hoffman Loan Assistance Repayment Program, by the Maryland Higher Education Commission, available at http://mhec.maryland.gov/preparing/Pages/FinancialAid/ProgramDescriptions/prog_larp.aspx
[66] Ibid.

- Teach in science, technology, engineering, or math subjects; or teach in a school in which at least 75% of the students are enrolled in the free meal program in the state for two years, and
- Have received the highest performance evaluation rating for the most recent year available in the county in which the teacher has taught.[67]

3. **Maryland Dent-Care Loan Assistance Repayment Program**: The state's loan assistance repayment program for dentists who treat Maryland's most vulnerable populations. Recipients must:

   - Serve three years, full-time in an eligible dental practice;
   - Treat a minimum of 30% Maryland Medical Assistance Program (MMAP) recipients as a portion of the total patient population per year;
   - Enroll with MMAP's Maryland Healthy Smiles program; and
   - Keep records of all patients treated (MMAP and non-MMAP) and provide monthly written reports to the Office of Oral Health.[68]

   Awardees receive up to $23,740 per year in student loan repayment up to three years.

4. **Maryland Loan Assistance Repayment Program for Physicians (MLARP) and the State Loan Repayment Program (SLRP)**: The MLARP is a State of Maryland loan repayment program for physicians and SLRP is a federal program that requires a 1:1 match to MLARP. The MLARP repays educational loans for physicians, physician assistants, and medical residents who must work for two-years in a health professional shortage area (HPSA) or a medically underserved area (MUA) or state designated health professional shortage area.[69] The SLRP repays educational loans for physicians and physician assistants who must work for two-years in a HPSA or MUA, either in primary care or mental health. An awardee's total amount cannot exceed $200,000, or two, two-year obligations at $50,000 per year.

[67] Ibid.
[68] Maryland Dent-Care Loan Assistance Repayment Program for Dentists, by the Department of Health and Mental Hygiene, available at http://phpa.dhmh.maryland.gov/oralhealth/pages/mdc-larp.aspx
[69] State Loan Repayment Program (SLRP) and Maryland Loan Assistance Repayment Program for Physicians (MLARP), by the Maryland Higher Education Commission, available at http://mhec.maryland.gov/preparing/Pages/FinancialAid/ProgramDescriptions/prog_mlarp.aspx

CHAPTER 6. Findings, Recommendations, and Discussion Question

Students who need money to pay for the cost of attending secondary education institutions (e.g., college, graduate school) can take out student loans. The federal government, state student loan authorities, and private lenders provide options for students to borrow money for education costs. Student loan *refinancing* occurs when a borrower replaces an existing student loan with a new loan with different terms.

Neither the state of Maryland nor Montgomery County currently have a student loan refinancing authority. In 2016, the Maryland State legislature passed enabling legislation to allow Montgomery County to establish a Student Loan Refinancing Authority (SLRA). Before the County can establish a SLRA, the enabling legislation (House Bill 1079) requires the County to conduct a study that, among other things, examines feasibility and demand and studies the operations of similar refinancing authorities in other systems. The purpose of this Office of Legislative Oversight report is to fulfill the study requirements in HB 1079.

This chapter summarizes the report findings, recommendations, and discussion questions developed by the Office of Legislative Oversight (OLO). The chapter has three sections:

- **Section A**, Summary of Report Findings;
- **Section B,** Recommendations; and
- **Section C,** Discussion Question.

A. Summary of Report Findings

<u>State Student Loan Program Characteristics (Chapter 1)</u>

- The federal government, some states, and private lenders provide options for students to borrow money for education costs. Most state programs are run by student loan authorities with exceptions like North Dakota, whose program is run by the state's Bank of North Dakota. Some of the larger programs, like South Carolina Student Loan, also provide loan services for other states.

- Currently, no counties run a student loan authority or a student loan refinancing authority; only state-level authorities exist.

- Most states student loan refinancing authorities require that a borrower:

    - <u>Be a resident of a state or attend a participating school of that state's authority</u> - State refinancing authorities require that the borrower be a state resident or a non-resident who went to school in that state. States with this requirement often finance their loan refinancing programs with tax-exempt Qualified Student Loan Bonds that have an Internal Revenue Service requirement that "the student has a nexus to the State for loans made to refinance student loans."[70]

    - <u>Be employed or have a minimum income</u> – Income requirements show a borrower's ability to repay a loan; income requirements range from $18,000 to $50,000.

[70] Internal Revenue Bulletin: 2015-48 by the Internal Revenue Service, available at https://www.irs.gov/irb/2015-48_IRB/ar08.html

- <u>Have an acceptable FICO score (often 670-720)</u> - Lenders use a borrowers' credit score created by the Fair Isaac Corporation (FICO) along with other details on borrowers' credit reports to assess credit risk and determine whether to extend credit. FICO scores are based on factors in five areas: payment history, current level of indebtedness, types of credit used, length of credit history, and new credit accounts.

- <u>Have an acceptable debt-to-income ratio (often 36-50%)</u> - A borrower's monthly debt payments divided by their gross monthly income. This number is one way lenders measure a borrower's ability to manage loan repayment.

- Most of the state student loan refinancing programs are open to borrowers who have not completed their degrees, reaching a larger audience but including borrowers who are more likely to default.

- State-level student loan financing authorities will forgive a loan if a borrower dies or becomes totally and permanently disabled (the loan does not have to be paid off). Some states, like South Carolina, forgive loans for students who work in certain professions (e.g., teaching) and/or who work with residents in underprivileged areas.

<u>Startup and Operating Costs for State Programs (Chapter 2)</u>

- Startup funding for a student loan refinancing program can cost as much as 20% of the total anticipated loan volume. For example, a $10 million student loan refinancing program would need up to $2 million in startup funds (funds needed to provide reserves for the initial loan program amount).[71] A Montgomery County student loan refinancing authority could not use existing bond proceeds for startup funds, which would have to come from another source. If the County established a program and sought to expand it, expansion would require additional funding.

- Most new student loan refinancing programs do a pilot in the first year, disbursing a comparatively small amount in loans and adjust their second-year funding based on first-year performance data.

- Some student loan refinancing authorities hire in-house staff to operate their programs and some authorities hire contractors.

- Three state-level programs' operating costs were studied closely due to similarities with Montgomery County: Rhode Island Student Loan Authority (similar population size); Louisiana Education Loan Authority (starting a new student loan refinancing authority); and Connecticut Higher Education Supplemental Loan Authority (starting a new student loan refinancing authority and they have a contractor-heavy services model). Each program contracts out some portion of services – ranging from staffing to software. Annual operating costs range from $708,000 to $1,028,000. The initial or startup operating costs ranged from $175,000 to $400,000.

<u>Student Loan Figures and Determining Demand (Chapter 3)</u>

- Student loan debt in the United States has reached $1.28 trillion – 44.2 million Americans have an average monthly payment of $351 and a median monthly payment of $203. An estimated $242 billion of this debt is eligible for refinancing.

[71] Reserves serve as collateral, which are assets pledged as a recourse to a lender if a borrower defaults on an initial loan.

- Based on figures for the class of 2015, the average Maryland graduate had $27,672 in student loan debt (below the national average of $30,100) and 56% of Maryland graduates left school with debt. Maryland's education loan market is the 24th largest in the country and dominated by federal loans.

- From a review of student loan data by zip code, average student loan balances in Montgomery County range from "slightly high" (10% to 25% above the national average student loan balance) to "extremely high" (65% to 100% above the national average).

- Overall, student loan delinquency in Montgomery County, where a borrower is late on a payment, is relatively low. Delinquency ranged from "Extremely Low" to "Somewhat Low" in 93% of County zip codes. In general, most zip codes in Montgomery County have high student loan balances with a low delinquency level.

- Montgomery County did not have any zip codes that had both low median income levels and low average student loan balances. This subset is the main group of borrowers most likely to be delinquent.

- The student loans debt characteristics of Montgomery County residents provides evidence of demand in the County for a student loan refinancing program. However, the full extent of the demand for a student loan refinancing authority cannot be accurately determined until key program characteristics are set, such as residency requirements, minimum credit score/credit history requirements, minimum/maximum loan amounts, interest rates, fees, and forgiveness options. Once program characteristics are set, a professional market study can accurately determine demand.

Feasibility of Implementing a Student Loan Refinancing Authority (Chapter 4)

- Maryland House Bill 1079, providing the legal authority for the County to establish a student loan refinancing authority, includes several requirements that the County must meet in order to establish an authority, including:
  - Study certain aspects of implementing an authority, including (1) performing a feasibility and demand[72] study, (2) assessing how an authority would impact recruitment and retention of County and school system employees, and (3) studying similar programs and operating costs of other authorities. [This OLO study is intended to meet these requirements.]
  - Hold public hearings, and
  - Provide opportunity for public comment.

- If the County decides to establish a student loan refinancing program under the state enabling legislation, the Council would need to enact legislation to do so.

- The Montgomery County Revenue Authority has expressed interest in administering a County student loan refinancing authority/program. The Revenue Authority is an instrumentality of Montgomery County and a public corporation created in 1957 to construct and operate a variety of self-supporting projects such as the air park and golf courses. The Revenue Authority's experience in program operation and in issuing bonds could be an effective match for a student loan refinancing program.

[72] The Council will need to engage an outside consultant to more specifically identify market demand in the County.

- Based on the review of state student loan programs, research, and interviews with finance professionals, establishing a County student loan refinancing program would require:
  - Identifying program characteristics and a market for student loan refinancing;
  - Financial resources, including startup costs, operating costs (initial and ongoing), a projection of revenue expectations, and the ability to issue bonds (already granted to an established authority by the state enabling legislation).
  - Qualified staff and/or contractors.
  - Physical office space and resources.

Policy Considerations when Establishing a Student Loan Refinancing Program (Chapter 5)

- Student loan refinancing programs can help jurisdictions fulfill public policy goals. For example, some programs are configured broadly to reduce or make college loan debt more affordable for a wide swath of loan-holders. Others are tailored to achieve a specific goal or help a specific group of loan holders. Other examples of public policy goals include increasing student funding/college access, recruiting and retaining County professionals, assisting low-income borrowers or other groups, and/or encouraging home ownership.

- The Texas Higher Education Coordinating Board has a higher education strategic plan focused on college access and minimizing student debt. The Board has a zero-interest loan program for qualified students.

- Multiple student loan authorities such as the Bank of North Dakota, the Rhode Island Student Loan Authority, and Iowa Student Loan are partnering with businesses to educate employees about student loan refinancing options. In particular, at Iowa Student Loan, employees who work for businesses that partner with the authority can lower their interest rate on their student loans (including an additional reduction for employees in STEM professions) and businesses can make payments toward employees' student loan.

- States such as California and Wisconsin target assistance to low-income and disadvantaged groups – assisting students throughout the financial aid process and providing need-based tuition grants.

- No student loan refinancing authorities studied in this report that have a program specifically benefiting teachers. Targeting teacher-borrowers could encourage recruitment and retention and/or provide an incentive to teach in critical geographic areas or in subjects that need more teachers.

- When evaluating whether to issue a loan, lenders look at borrowers' debt-to-income ratio, which is a borrower's monthly debt payments divided by their gross monthly income. This number is one way lenders measure a borrower's ability to manage loan repayment. Lenders look at debt-to-income ratio when issuing both student loans and mortgages.

- Refinancing a student loan can lower a borrower's debt-to-income ratio in several ways, such as reducing the interest rate while keeping the same term length for the loan or increasing the term length with a similar interest rate. Lowering the debt-to-income ratio can increase the likelihood of being approved for a mortgage.

B. Recommendations

The Office of Legislative Oversight presents the following recommendations for Council consideration.

Recommendation #1: Determine technical and policy characteristics; engage a consultant to conduct a market demand study.

If the Council would like to establish a student loan refinance program, the Council needs to identify program characteristics and public policy goals – both of which will impact demand for the program. The technical characteristics include required credit scores, amount of debt, interest rates, applicant income level, their residency status, and their overall level of need. Policy goals can drive the focus of a program (e.g., does the program want to help current students with debt, increase housing, target low income students, attract residents to the County, etc.?).

Once these characteristics are determined, OLO recommends that the Council engage a private consultant to conduct a detailed study of the demand for student loan refinancing in Montgomery County. A consultant can help the County determine the student loan market, competition, viable loan products, marketing strategies, and steps for a rollout plan.

Recommendation #2: If the Council wants to establish a student loan refinancing authority, consider establishing it as a component of the Montgomery County Revenue Authority.

The Montgomery County Revenue Authority is an instrumentality of Montgomery County and a public corporation created in 1957 to construct and operate a variety of self-supporting projects, such as the Montgomery County Air Park and golf courses. Representatives of the Montgomery County Revenue Authority have expressed interest in administering a student loan refinancing program in the County if the Council chooses to establish one. The Revenue Authority's experience could make it an effective match to operate a student loan refinancing program.

If the Council considers the Revenue Authority as an entity to operate a student loan financing program, the County could establish a relationship model like Connecticut's, where the executive director of the Connecticut Health and Educational Facilities Authority (CHESLA) is also executive director of the Connecticut Higher Education Supplemental Loan Authority.

C. Discussion Question

Should the County wait until the study currently in progress by the Maryland Department of Legislative Services (DLS) about a State student loan refinancing authority is complete?

DLS currently is conducting a study required by House Bill 1015, which is looking at the "expansion or creation of an appropriate bonding authority for the refinancing of student loans in Maryland." DLS expects to complete the study by September 30, 2017. Given the overlapping subject matter and the fact that student loan refinancing authorities typically are operated at the state level, should the Council wait until the DLS study is complete before deciding whether to actively pursue a local student loan refinancing authority?

CHAPTER 7. Agency Comments

The Office of Legislative Oversight circulated a final draft of this report to the Chief Administrative Officer for Montgomery County. OLO appreciates the time taken by County Government representatives to review the draft report and provide comments. OLO's final report incorporates technical corrections provided by County staff. The written comments received from the Chief Administrative Officer are attached in their entirety beginning on the next page.

OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

June 9, 2017

To: Chris Cihlar, Director, Office of Legislative Oversight

From: Timothy L. Firestine, Chief Administrative Officer (CAO) Timothy L. Firestine

Subject: OLO Draft Report 2017-8: Student Loan Refinancing Authority

Thank you for the opportunity to comment on the Office of Legislative Oversight's (OLO) Draft Report 2017-8: Student Loan Refinancing Authority. The draft report included the following recommendations and discussion question:

- **Recommendation #1**: Determine technical and policy characteristics; engage a consultant to conduct a market demand study
- **Recommendation #2**: If the Council wants to establish a student loan refinancing authority, consider establishing it as a component of the Montgomery County Revenue Authority
- **Discussion Question**: Should the County wait until the study currently in progress by the Maryland Department of Legislative Services (DLS) about a State student loan refinancing authority is complete?

Following is our response to these recommendations and discussion question:

Student loan debt is the largest and fastest growing share of consumer (non-housing) debt and has the highest delinquency rate of all consumer credit debt. As a result, there are few states and no localities willing to incur the financial risk and significant cost of operating a Student Loan Refinancing Authority.

Creating a Student Loan Refinancing Authority would require significant County financial resources. Existing County financial resources and already limited debt capacity are best devoted to current operating budget and planned capital construction requirements. If implemented, a Student Loan Refinancing Authority will seriously impact many of our critically important programs ranging from K-12 education to safety and transportation, and limit our ability to assist those County residents most in need of assistance. A County program for refinancing of student loan debt is not fiscally responsible and not recommended as the highest and best use for County financial resources.

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Furthermore, to start a Student Loan Refinancing Authority a large infusion of cash from the General Fund or from County debt issuance would be needed to capitalize an Authority to initiate the refinancing of student loans. As a start-up Student Loan Refinancing Authority, the County lacks the benefit of an existing, seasoned portfolio of loans that can be leveraged to fund and collateralize new loans. Therefore, a Student Loan Refinancing Authority will require funding, either through County appropriation or County debt financing to make refinancing loans to student borrowers and to endow reserves to collateralize the initial pool of loans.

The County's financial advisors have estimated that to fund an initial loan portfolio of $100 million, an additional $20 to $30 million would be needed to fund reserves and to provide additional debt service coverage. Even with strong reserves, the credit rating of the new bonds secured by student loan repayments is uncertain until we know more about the underlying credit quality of the student loan borrowers. It is unlikely that the County could meet the start-up funding requirements of the Student Loan Refinancing Authority without issuing debt, which would further add to the County's already high debt ratios. While it is assumed the Student Loan Refinancing Authority would eventually be able to pay back the start-up funding to the County, in the meantime the County would pay the debt service and other program costs which would draw down County General Fund reserves and potentially crowd out funding for other important County programs.

The County's financial advisors have also estimated, based on a $50 to $100 million lending program, that start-up funding and ongoing operating costs could be as much as $1 million annually for three to five years until the portfolio of loans is established and generating income to fund operations. It is unknown where this required level of funding may come from in order to start a Student Loan Refinancing Authority. Currently, funded County programs and/or services would need to be cut or reduced to fund such a program. Based on current budgetary constraints, existing debt ratios, and other operating and capital budget priorities, this type of initiative is not affordable in the foreseeable future.

The report provides good information about what some States are doing in the Student Loan Refinancing market and their start-up cost experience. While this is good information, State law requires a more detailed analysis and further information before decisions can be made regarding the parameters of local legislation creating a Student Loan Refinancing Authority. We believe that out of the three study requirements in House Bill 1079, the OLO study does not include the feasibility and demand study requirement and the required assessment of potential benefit to recruitment and retention of County and Montgomery County Public School (MCPS) employees.

The OLO report states that it is intended to constitute the study required by House Bill 1079 (2016), which requires that a study be conducted by the County before enacting local legislation to establish a Montgomery County Student Loan Refinancing Authority. House Bill 1079 provides that:

> "(A) Before Montgomery County may establish the Montgomery County Student Loan Refinancing Authority the County shall:
>
> (1) Study aspects of implementing the Authority in accordance with State and County law, including:

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June 9, 2017
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(I) Perform a feasibility and demand study;

(II) Assessing the potential benefit to recruitment and retention of County and school system employees; and

(III) Studying the operation of similar programs in other systems, including operating costs."

Regarding the required demand study, the OLO report does not gather and evaluate County-specific market data concerning potential borrowers with respect to total student loan debt outstanding and the current interest rates of that student loan debt as well as data concerning interest rates being offered by private sector entities providing refinancing loans. This information is needed to assess and determine the ability of a Montgomery County Student Loan Refinancing Authority to be successful and financially self-supporting in the student loan refinancing market. The OLO Report acknowledges in several places (pages 21 and 33, footnotes 38 and 72, and recommendation #1) that the Council must engage an outside consultant to perform the proper type of demand study. The report only notes that there "appears to be a demand" for student loan refinancing based on the propensity of student loans in Montgomery County.

The OLO report used Experian sample data for autumn 2015 and 2013 American Communities Survey data. The type of data presents averages, which are not the best measure to be used as the basis for recommending implementation of a refinancing program. At a minimum, median data would be a better indicator of whether or not the County could compete with existing student loan interest rates to offer a reduced cost alternative for borrowers. A distribution of the value of outstanding loans by interest rates as well as the current structure of the loans (five years, 10 years, and 20 years) is needed. The issue of who holds the loans is also important as this dictates the terms and conditions that may apply for the replacement loan. Loans from a new entity would be made to individuals based on current outstanding debt, existing interest rates, and credit scores/ability to repay the debt. A true demand study still needs to be conducted prior to the implementation of a Montgomery County Student Loan Refinancing Authority.

Regarding the required feasibility study, the OLO report acknowledges (on page 21) that the Council would need to engage an outside contractor to perform a loan product development plan, in addition to a detailed demand study, which cannot be done without information on specific program characteristics such as residency requirements, credit history, maximum loan amounts, and interest rates. In addition to a loan product development plan, the OLO Report notes (on page 34) that the feasibility of a student loan refinancing program depends on (1) program characteristics; (2) market, financial resources, including startup costs, operating costs (initial and ongoing), a projection of revenue expectations, and the ability to issue bonds; (3) availability and cost of qualified staff and/or contractors; and (4) cost of physical space and other resources.

According to William Dudley, President of the New York Federal Reserve Bank, there is $1.3 trillion in student loan debt and loan delinquency has climbed to 11.2 percent in the last quarter of 2016, the highest rate for all types of household debt. Student debt repayment involves significant risk. A lender in this market must be prepared to experience losses and have adequate reserves to cover these losses. The high costs and risks associated with such programs are key reasons why very few States and no localities are in this market.

When the "Best Student Loan Refinance 2017" is searched on Google, results show that there are seven private sector lenders, that receive 9.5 to 8.4 ratings out of a total score of 10, who offer refinancing options on the internet for student loan debt refinancing for Montgomery County residents: SoFI, credible, LendKey, lendedu, DRB, CommonBond, Lendingtree, and CollegeAve. In addition, there are seven other companies that are listed: DocuPop, Discover, Wells Fargo, Sallie Mae, Citizens Bank, iHELP, and Earnest. The large number of lenders already in this market can offer economies of scale, and it is unknown if a Montgomery County Refinancing Authority would be able to cover its own start-up costs, on-going costs, and defaults while being able to offer competitive interest rates for those wishing to refinance. Governmental and private lenders in this market make use of variable rate debt, interest rate swaps, and other derivative products. The County's debt and investment policies do not permit the use of or investment in derivatives because of the risks associated with the loss of principal. This may present an issue for a County entity as it attempts to offer competitive interest rates to those available in the private sector.

To develop a Student Loan Refinancing program, start-up operating funding and an initial bond offering with adequate reserve funding would be necessary to collateralize the initial pool of loans. It is unclear where this funding would come from and how it might impact the County's budget and debt capacity. This is why a feasibility/demand study is of critical importance. The cost of such a study was estimated to be between $100,000 and $300,000. It is needed to assess the potential size of the loan portfolio and the related debt issuance and operating costs that could be incurred. It would assist the County in determining the public demand for a student loan refinancing program beyond those programs offered by private loan providers. It is unclear whether a Montgomery County Student Loan Refinancing entity could be competitive with established lending institutions operating in this market area.

Another requirement of House Bill 1079 is to assess the potential benefit to recruitment and retention of County and MCPS employees. The OLO report does not address this issue in any depth. It is unclear what the benefits would be to Montgomery County compared to the costs for implementing such a program.

Finally, with regard to discussion question posed in the OLO Report, the report notes:

> "DLS currently is conducting a study required by House Bill 1015, which is looking at the "expansion or creation of an appropriate bonding authority for the refinancing of student loans in Maryland." DLS expects to complete the study by September 30, 2017. Given the overlapping subject matter and the fact that student loan refinancing authorities typically are operated at the state level, should the Council wait until the DLS study is complete before deciding whether to actively pursue a local student loan refinancing authority?"

We note that, under House Bill 1015 (2016), the State study is being conducted by the Maryland Higher Education Commission and the Maryland Health and Higher Educational Facilities Authority, in consultation with the Department of Legislative Services (DLS). The State study must be completed by September 30, 2017.

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Given the complexity of issues relating to student loan refinancing programs, and the level of resources that are required to complete the type of local study outlined in House Bill 1079, we believe it would be prudent for the Council to wait until the State study is completed before making further decisions about how to complete the type of local study that is required by House Bill 1079. However, regardless of the finding of the State study, we do not recommend that Council pursue a Student Loan Refinancing Authority as such a program is not fiscally responsible and is not the highest and best use of our limited County financial resources.

cc: Fariba Kassiri, Assistant Chief Administrative Officer
Bonnie Kirkland, Assistant Chief Administrative Officer
Alexandre A. Espinosa, Director, Department of Finance
Melanie Wenger, Director, Office of Intergovernmental Relations
Shawn Y. Stokes, Director, Office of Human Resources

Appendices

APPENDIX A: State Student Loan Authorities' Websites

State	Authority	Website
Alaska	The Alaska Commission on Postsecondary Education	http://acpe.alaska.gov/
Connecticut	Connecticut Higher Education Supplemental Loan Authority	http://www.chesla.org/
Iowa	Iowa Student Loan	http://www.iowastudentloan.org/
Kentucky	Kentucky Higher Education Student Loan Corporation	http://www.kheslc.com/
Louisiana	Louisiana Education Loan Authority	http://www.studentloan.org/private-loan-programs/lela-main.aspx
Maine	Finance Authority of Maine	https://www.theloanforme.com/
Massachusetts	Massachusetts Educational Finance Authority	https://www.mefa.org/
Minnesota	Minnesota Office of Higher Education	http://www.ohe.state.mn.us/
New Hampshire	New Hampshire Higher Education Loan Corporation	http://www.edvestinu.com/
New Jersey	Higher Education Student Assistance Authority	http://www.hesaa.org/
North Dakota	Bank of North Dakota	https://bnd.nd.gov/
Rhode Island	Rhode Island Student Loan Authority	https://www.risla.com/
South Carolina	South Carolina Student Loan	https://www.scstudentloan.org/
Texas	Texas Higher Education Coordinating Board	http://www.hhloans.com/
Vermont	Vermont Student Assistance Corporation	http://www.vsac.org/

APPENDIX B: Student Loan Refinancing Examples from the Rhode Island Student Loan Authority

Profile	Borrower 1 Parent of Two College Graduates	Borrower 2 Business School Graduate	Borrower 3 Working Professional
Current Loans	5 Parent PLUS Loans	3 Private Student Loans	4 Private Student Loans
Original Interest Rates	7.9% - 8.5%	6.86% - 7.74%	6.49% - 8.49%
Amount to Repay	$51,987	$102,360	$45,394
Refinance Interest Rate	5.39%	5.39%	5.99%
Refinance Terms	10-Year, Cosigned Loan	10-Year, Cosigned Loan	15-Year, Cosigned Loan
Monthly Payment Decrease	$117	$65	$36
Total Interest Savings	$5,550	$26,966	$6,443

APPENDIX C: Memorandum from Joseph F. Beach, Director, Department of Finance, to Isiah Leggett, County Executive on MC 27-16: Montgomery County Student Loan Refinancing Authority. January 28, 2016.

DEPARTMENT OF FINANCE

Isiah Leggett
County Executive

Joseph F. Beach
Director

MEMORANDUM

January 28, 2016

TO: Isiah Leggett, County Executive

FROM: Joseph F. Beach, Director
Department of Finance

SUBJECT: MC 27-16: Montgomery County Student Loan Refinancing Authority

This memorandum is intended to highlight some of the implementation issues and suggested amendments related to the subject legislation. Due to the implementation issues outlined below we recommend that the County further study these issues including a demand analysis; funding requirements; ramp-up and operating costs; eligibility requirements; and experience and lessons learned in other jurisdictions. A clearer understanding of these implementation issues will provide a stronger basis for developing the enabling legislation.

Non-Recourse Private Student Loans – Upfront and Ongoing Funding

1) To implement a Student Loan Refinancing Authority, a large infusion of cash would be required to establish this entity and initiate providing loans or refinancing existing student loans The exact potential funding requirement is unknown; however, the County's financial advisors have estimated a possible funding requirement of $50 to $100 million which would be needed from the State, County General Fund appropriations or from the proceeds of County debt financing in order to initialize such a lending institution.
2) The financial feasibility/sustainability of operating a County student loan program and providing a possible lower student loan interest rate alternative than those currently available within this market is unknown. County interest rate subsidization may be required; otherwise the County may not be able to offer a competitive interest rate alternative. For example, rates offered by the federal government for Academic Year 2015-16 for subsidized and unsubsidized Stafford loans are 4.29%, 5.84% for Unsubsidized Graduate/Professional student loans, and 6.84% for Direct PLUS Loans. The County would need to be able to either match or improve upon these rates in a refinancing or new student loans either by lending its own money below these rates or by obtaining debt at below these rates. Even with the historically low rates in

Isiah Leggett, County Executive
January 28, 2016
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rates or by obtaining debt at below these rates. Even with the historically low rates in the current municipal market it would be difficult to sell debt below or even near 4.29% for student loans because it would be taxable (private use) and have to adjust for the default and delinquency rates in the student loan market.

3) We recommend that the legislation be amended to clarify that any bonds issued by the new Student Loan Refinancing Authority be non-recourse to the County Government. This will eliminate taxpayer exposure to defaults and would require these asset-backed securities (ABS) to be secured by credit enhancement in the form of (i) Over-Collateralization, (ii) Subordination, and (iii) Excess Spread.

4) As a start-up Student Loan Refinancing Authority, the County lacks the benefit of an existing, seasoned portfolio of loans that can be leveraged to collateralize new loans. Start-up funding will be needed to endow the reserves necessary to collateralize the initial pool of loans. The amount required will need to be significant ($20 to 30 million assuming a loan portfolio of $100 million) so the Authority can originate and accumulate a quality portfolio of student loans with proper levels of overcollateralization, reserves, and excess spread before securitizing.

5) Further, until the portfolio of loans is established and generating upfront and annual fee income to fund operations, the Authority will require funding for on-going operations for several years of ramp up until the loan portfolio and fee and interest income is large enough to support Authority operations. The student loan rate would need to be increased to generate revenue to fund loan servicing expenses, including billing, collecting and customer service. This is estimated to add 1% on top of the cost of funds. Also, until the student loan portfolio is established these loan servicing and administrative costs would need to be funded from an alternative source. Depending on how quickly the portfolio of loans is originated, the funding subsidy for operations could be significant, up to $1 million per year during the first 3-5 years of ramp up.

6) Amendments should be considered to carefully define program eligibility for County residents, especially if the Authority is subsidized in part or wholly by the County general fund. This could also be accomplished through regulations developed subsequent to passage of the legislation. However, given the mobility of residents in the Washington Metropolitan area, screening for eligibility will be another challenge in program implementation.

<u>Non-Recourse Private Student Loans – Structure Issues</u>

7) Student-loan ABS are typically sold in "tranches". The rules set forth in the documents allocate loan losses and student loan repayments among the tranches. The majority of student loan securitizations issued to date have (i) multiple AAA rated

senior classes that pay sequentially, (ii) a mezzanine class often structured as AA rating, and (iii) a subordinate tranche rated in the BBB category. The structure and target credit rating will impact how much over-collateralization and excess spread are in the securitization. Without information on what the new portfolio might contain, it is difficult to estimate requirements for loan loss reserves.

8) Over-collateralization and excess spread usually comprise 15% to 100% of the expected total credit enhancement for each rated tranche in the securitization. So, the size of the start-up grant / appropriation will depend on the target credit rating and structuring of the offering. For example, assuming 100% collateralization of loans and an initial offering rated AAA, greater levels of leverage at lower credit ratings can be determined once the underlying credit quality of the portfolio is known.

9) To more accurately assess the potential size of the loan portfolio and the related debt issuance and operating costs the County should perform a detailed feasibility/demand study. This study would assist the County in determining all potential program costs and the public demand for another source of new student loans and student loan refinancing in addition to existing federal and private loan programs. To fully identify the estimated market size and therefore the initial cash sizing as well as associated program costs, a feasibility/demand study is recommended. It is estimated that such a study would cost in the range of $100,000 to $300,000.

<u>Non-Recourse Private Student Loans – Other Financing Issues</u>

10) Interest rate swaps may be a useful tool to manage interest rate risk in the portfolio. There is no provision in the legislation permitting the use of swaps. Caution should be used in whether to authorize the use of swaps which are derivative securities. The County's investment policy does not permit investment in derivatives because of the risks in loss of principal.

11) Student loan bond issues are issued on a negotiated basis. There have only been a handful of student loan debt issues done on a competitive basis, which is not advised under current market conditions. The legislation provides for this flexibility in issuance.

12) Specialized Field – banking fees, legal fees, rating agency fees, financial advisory fees, trustee fees are significantly higher than a typical County General Obligation bond sale or an Appropriation Backed debt issuance. Issuance costs for a student loan debt issuance could be 2x to as much as 10x higher than what is paid on a typical County issue - $2 to 3 million is estimated assuming a $50 to $100 million securitization.

<u>Non-Recourse Private Student Loans – Credit and Eligibility Considerations</u>

Isiah Leggett, County Executive
January 28, 2016
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13) Credit Scores - typical student loan ABS have minimum FICO scores of 740 and co-signers on 85% of the loans. As a point of reference, in 2015 Sallie Mae originations had an average FICO score of 749 and co-signers on 90% of the loans. However, as a matter of policy the County may want to consider whether this level of FICO scores or co-signing is required as a program eligibility requirement. Permitting wider access to the program would benefit a broader cross section of the County, but would also affect the debt issuance costs and market interest rate because of the increased risk of default and need for increased credit enhancements such as debt service reserve funds.

14) Origination Channel & School Certification – the traditional model is for loans to be marketed through traditional school channels and financial aid offices, which have established checks and balances, vs. direct to consumer (DTC) marketing and disbursement, which has inherently more risks. The most appropriate channel should be determined prior to program adoption, especially since the program is targeted to benefit Montgomery County residents and eligible participants.

15) School Type and Degree – what are the criteria for schools / tuition that can be funded? Two-year institutions? Four year institutions? Proprietary or vocational schools? The legislation is fairly broad here on eligibility.

16) Borrower concentration– credit score diversity of the student loan portfolio is a key credit consideration. With a program open to Montgomery County residents and other eligible participants, diversity will be a challenge and viewed as a potential credit negative. This can be offset by elevated reserves, over-collateralization and higher FICO scores / credit quality of the underlying loans.

Attachment

copies
Timothy L. Firestine, Chief Administrative Officer
Melanie Wenger, Director, Office of Intergovernmental Relations
Bonnie Kirkland, Assistant Chief Administrative Officer
Joy Nurmi, Special Assistant to the County Executive

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January 28, 2016
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Terms Defined:

(i) **Over-Collateralization**: The process of posting more collateral than is needed to obtain or secure financing. Over-collateralization is often used as a method of credit enhancement by lowering the creditor's exposure to default risk. Over-collateralization is often done in order to get a better debt rating from a credit rating agency. The principal underlying a pool of assets is often greater than the principal amount of the issued security by approximately 10 to 20%.
For example, in the case of an asset backed security (ABS), the principal amount of an issue may be $100 million while the principal value of the assets underlying the issue may be equal to $120 million.

(ii) **Subordination**: A clause in an agreement which states that the current claim on any debts will take priority over any other claims formed in other agreements made in the future. Subordination is the act of yielding priority. A subordination clause effectively makes the current claim in the agreement senior to any other agreements that come along after the original agreement. These clauses are most commonly seen in mortgage contracts and bond issue agreements. For example, if a company issues bonds in the market with a subordination clause, it insures that if more bonds are issued in the future the original bondholders will receive payment before the company pays all other debt issued after it. This is added protection for the original bondholders as the likelihood of them getting their investment back is higher with a subordination clause.

(iii) **Excess Spread**: Remaining net interest payments from the underlying assets of an asset-backed security, after all payables and expenses are covered. The excess spread can be deposited into a reserve account in order to enhance the credit of the asset-backed security, or it can be paid out to investors.

(iv) **Tranches**: A piece, portion or slice of a deal or structured financing. This portion is one of several related securities that are offered at the same time but have different risks, rewards and/or maturities. Tranche is a term often used to describe a specific class of bonds within an offering wherein each tranche offers varying degrees of risk to the investor.

(v) **Swaps**: A swap is a derivative contract through which two parties exchange financial instruments. These instruments can be almost anything, but most swaps involve cash flows based on a notional principal amount that both

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parties agree to. Usually, the principal does not change hands. Each cash flow comprises one leg of the swap. One cash flow is generally fixed, while the other is variable that is, based on a benchmark interest rate, floating currency exchange rate or index price.