STUDENT LOAN REFINANCING IN MARYLAND

Findings and Recommendations Related to the Advisability of Establishing a State Student Loan Refinancing Program

As Required by Chapter 290 of 2016

MARYLAND HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY
MARYLAND DEPARTMENT OF LEGISLATIVE SERVICES

OCTOBER 2017

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Maryland Health and Higher Educational Facilities Authority
Maryland Department of Legislative Services

October 2017

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Chapter 1. Summary of Findings and Recommendations

Introduction

In response to House Bill 1015 of 2016 (Chapter 290), the Maryland Health and Higher Educational Facilities Authority (MHHEFA) and the Department of Legislative Services (DLS) have completed the following report on student loan refinancing in Maryland. As originally described in the fiscal and policy note for House Bill 1015, the study was anticipated to be completed by a consultant with access to market-specific data hired by the Maryland Higher Education Commission (MHEC) at a cost of $50,000 (an estimate that has since been increased). However, no funding was provided by the Governor for a consultant. Absent that funding, MHHEFA and DLS undertook the study directly with consultation from MHEC. However, without the consultant study, the central question of whether establishing a student loan refinancing program in Maryland is advisable remains unanswered. This report describes what was able to be determined with publicly available student loan information, through surveys of other states' programs, and through the general knowledge MHHEFA and DLS have of the capital debt markets. This chapter provides a summary of the findings and recommendations, while the following chapters provide additional background information, support, and detail.

The State Should Approach a Refinancing Program with Caution

The results of this study are inconclusive regarding whether establishing a student loan refinancing program in Maryland is advisable. There is a finite market for refinancing student loans. Maryland residents currently have access to student loan refinancing services from several state programs, including Kentucky, Rhode Island, and Massachusetts, and many private lenders. A State program would have to compete with these established entities. Further, recent trends in federal student loan interest rates and generous federal repayment plans are likely placing downward pressures on demand for refinancing. There are also significant unknowns when discussing program start-up costs, ongoing operating costs, and borrowing costs. In this environment, a State student loan refinancing program is not guaranteed to be viable or the best use of limited State resources.

If State policymakers decide to continue pursuing the establishment of a student loan refinancing program, it is strongly recommended that a consultant be hired to first conduct a market-specific study. The generally available student loan information presented in Chapter 3 of this report is insufficient to determine the costs, demand for, and long-term viability of a State student loan refinancing program. The market-specific study, which is further described below, is estimated to cost between $100,000 and $250,000 and should be directed by the State entity that would potentially run the program. The study should also consider the possibility and financial implications of concurrently establishing a State program to directly provide student loans. Given the lack of funding provided by the Governor to-date, the General Assembly may wish to consider legislation that requires a consultant to be hired and mandates funding for the study.

Even if the consultant study were to determine that a State student loan refinancing program is feasible, it remains a policy decision as to whether establishing a program is the best use of the State's limited financial resources. Preliminary estimates, as discussed in Chapter 5, place start-up costs at 25% to 30% of an initial program size, with the majority of this amount being used as a credit enhancement for the bonds issued to fund the program. Additional funding for operating costs, which could range from $0.5 million to $1.0 million annually for several years before a program is self-funding, would also be required. Some or all of the funding for these costs may need to be in the form of a grant and/or a loan from the State. The use of any State funds should be balanced against their use for other purposes.

If the consultant study determines that a State student loan refinancing program is feasible and the State decides to establish the program, then MHHEFA is the entity best suited to operate the program, with certain statutory changes. As discussed in Chapter 6, there is no State entity that is perfectly suited to run a State refinancing program; however, experience and expertise surrounding the issuance of debt is essential to a successful program. MHHEFA's long experience and positive reputation in the public debt markets make it best suited to offer a program – likely in conjunction with one or more professional loan servicers to assist with loan administration. MHHEFA's statute would need to be altered to explicitly authorize a student loan refinancing program. However, care should be taken to not over-prescribe program details, as the flexibility to respond to changing markets is critical.

If the State establishes a student loan refinancing program, then local programs should be prohibited; however, if the State does not establish a program, then local programs may be appropriate. If the State establishes a student loan refinancing program, then the addition of one or more local refinancing programs may oversaturate the market and jeopardize the viability of both the State program and the local programs. If counties and other jurisdictions still wish to offer support for student loan refinancing, then their role should be limited to providing financial literacy counseling and information regarding the State program and other refinancing options, assistance with loan applications, and similar assistance.

Conversely, if the State decides to not establish a student loan refinancing program, then one or more local programs may offer a valuable in-state government/nonprofit resource for student loan refinancing. While local refinancing programs may wish to focus solely on their residents, in the absence of a State program, it would be the most efficient use of limited resources if one local program served all State residents.

As discussed in Chapter 2, currently, Montgomery County is authorized by statute to establish a county program. Prince George's County is also studying the establishment of a program.

Market-specific Consultant Study

As recommended above, if the State decides to continue pursuing the establishment of a program, the State should first engage a consultant to study program costs, conduct a market demand analysis, determine market competition, and consider the economic impacts. Due to the experiences of other states, which added refinancing programs to existing direct student loan programs, the study should consider the possibility and financial implications of concurrently establishing a program to directly provide student loans in addition to a refinancing program. A study of this scope is estimated to cost between $100,000 and $250,000 and should be directed by MHHEFA, the entity that this report recommends is best suited to run a State program. The following factors should be included in the study but are not all-inclusive.

Cost Analysis

The consultant should determine the amount necessary to fund a student loan refinancing program, including the amount required to establish a default reserve fund for the initial pool of loans to be refinanced through the bond offering, as well as start-up and ongoing operational costs. In order for the consultant to properly analyze these costs, feedback would need to be provided concerning the size of the program and the borrowers eligible for the program (*e.g.*, the credit profile of the borrowers). The required investment by the State for a viable program, through cash and/or other support, such as a guaranty, should also be addressed.

Demand Analysis

The demand for a student loan refinancing program depends upon the ability of the program to offer interest rates that are lower than the rates on borrowers' existing loans under various market conditions, as well as the creditworthiness of the borrowers. As part of the broader study, the consultant should ascertain, among other things, the outstanding balance of student loans held by residents of the State and the interest rates prevailing on those loans. The potential impact of one or more county programs on a State program should also be examined.

Competition

Both the public and private sector offer borrowers the opportunity to refinance student loans. The consultant should study the competitive landscape of student loan refinancing alternatives, including the rates offered by existing providers as compared to the rates that a State program could offer (making various assumptions regarding, among other things, the credit profile characteristics of the borrowers, any co-signers, and the size of the initial default reserve fund).

Economic Impact

The consultant should also study the amount of disposable income borrowers could save assuming that their borrowing costs are reduced by refinancing under the program. This will provide the State with an opportunity to review the potential economic impact that could be achieved by offering a student loan refinancing program offering competitive interest rates that may not otherwise be available in the marketplace.

Direct Student Loan Program

Except for Louisiana, all states that currently refinance student loans also offer student loans directly to students. Given this broad national trend, the consultant should study the financial implications of the State establishing a direct student loan program in addition to a refinancing program.

Chapter 2. Legislative History

Study of Student Loan Refinancing in Maryland

The Maryland General Assembly has long been concerned with the ever-increasing costs of higher education and interested in policy options to alleviate these costs. For example, the College Affordability Act of 2016 established a matching grant to help individuals save for college, created a refundable tax credit for undergraduate student loan debt, and increased incentives for students to enroll full time. That same year, the General Assembly separately considered the establishment of a student loan refinancing program to reduce the burden of student loan debt by refinancing existing student loans at potentially better interest rates and/or repayment terms. In many cases, borrowers can pay significantly less over the life of a refinanced loan than they would have otherwise. However, student loan refinancing programs are not without their costs and risks.

In recognition of the complexities surrounding such programs, House Bill 1015 of 2016 (Chapter 290) required the Maryland Higher Education Commission and the Maryland Health and Higher Educational Facilities Authority (MHHEFA), in consultation with the Department of Legislative Services (DLS) and any other appropriate agencies, to study the expansion or creation of an appropriate bonding authority for the refinancing of student loans in Maryland. The study must examine four specific aspects of student loan refinancing:

- whether there are any entities in the State that have bonding authority and currently have the capability and the capacity to offer a student loan refinancing program;
- whether there are any entities in the State that have bonding authority and do not currently have the capability or the capacity to offer a student loan refinancing program, but might be a viable option to offer the program if certain changes were made to the entity;
- student loan refinancing programs offered in other states, including eligibility requirements, essential program characteristics, and start-up and operational costs; and
- the role of counties or other jurisdictions in offering student loan refinancing programs.

Further, the study must make findings and recommendations on:

- the entities in the State that are best suited to offer a student loan refinancing program and whether any statutory changes would be necessary to enable those entities to offer a program;

- program characteristics that are essential for a successful student loan refinancing program in Maryland;

- the projected start-up and operational costs for a successful student loan refinancing program in Maryland;

- best practices and lessons learned from the review of other states' student loan refinancing programs; and

- the role of counties or other jurisdictions in offering student loan refinancing programs.

The fiscal and policy note for House Bill 1015 anticipated $50,000 in funding for a consultant to conduct the study (an estimate that has since been increased). However, no funding was provided by the Governor. Without that funding, MHHEFA and DLS undertook the study directly to make what findings and recommendations were possible without the consultant.

County Studies of Student Loan Refinancing Authorities

Interest in student loan refinancing programs extends beyond just the State level. During the 2016 and 2017 sessions, legislation was enacted for Montgomery County and Prince George's County to study student loan refinancing authorities at the county level.

Montgomery County Student Loan Refinancing Authority

Sponsored by the Montgomery County delegation to the General Assembly, House Bill 1079 of 2016 (Chapter 296) authorized Montgomery County to create the Montgomery County Student Loan Refinancing Authority, subject to certain conditions. The law requires the county to study certain aspects of a county student loan refinancing program, including (1) performing a feasibility and demand study; (2) assessing the potential benefit to recruitment and retention of county and school system employees; and (3) studying the operation of other similar programs, including operating costs. The Montgomery County Office of Legislative Oversight (OLO) released a report in June 2017, entitled *Student Loan Refinancing Authority (OLO Report 2017-8)*, which was intended to fulfill the study requirements of Chapter 296.

As there are no federal or county-level student loan refinancing programs, the OLO report primarily focused on state-level programs that offer student loan refinancing. Except for Louisiana, which ceased offering student loans in 2010, all other states that currently offer student loan refinancing also offer student loans. To avoid unnecessary duplication of effort, some of the information collected in the OLO report has been used to supplement information gathered for this analysis, as noted in various chapters below.

The OLO report concluded that although the student loan debt characteristics of Montgomery County residents provide evidence of demand in the county for a student loan refinancing program, the full extent of the demand cannot be accurately determined until the county council sets the key program characteristics, such as residency requirements, minimum credit requirements, types of loans to be offered, *etc*. After program characteristics are set, then a professional market study can accurately determine demand. Additionally, the study found that establishing a county student loan refinancing program would require (1) the county council to enact legislation; (2) financial resources, including start-up costs, operating costs, a projection of revenue expectations, and the ability to issue bonds; (3) qualified staff or contractors; and (4) physical office space and resources.

The OLO report made two recommendations: (1) determine technical and policy characteristics and engage a consultant to conduct a market demand study; and (2) if the county council wants to establish a student loan refinancing authority, consider establishing it as a component of the Montgomery County Revenue Authority, which has years of experience in issuing taxable and nontaxable bonds.

The OLO report also asked whether the county should wait until this statewide study regarding student loan refinancing programs required by Chapter 290 of 2016 is complete. The report noted that student loan refinancing authorities are typically operated at the state level.

The OLO report contains agency comments from the Montgomery County Chief Administrative Officer (CAO) expressing concerns about establishing a student loan refinancing program in Montgomery County. The CAO recommends that the county council wait for the results of the statewide study before making further decisions about how to complete the local study. However, the CAO states that "regardless of the finding of the State study, we do not recommend that [the] 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."

In July 2017, after receiving a briefing on the OLO report, the Government Operations and Fiscal Policy Subcommittee and the Education Subcommittee of the Montgomery County Council agreed to pursue hiring a consultant to do a market study; however, a vote of the full county council to fund the study is not expected until late October.

Under Chapter 296, Montgomery County's statutory authorization to establish a student loan refinancing authority is not subject to termination. However, if the county does not establish an authority and notify DLS by June 30, 2019, contingent provisions that would include the authority in the Local Government Tort Claims Act are repealed. While this does not affect the ability of Montgomery County to establish an authority after that date, any authority established would not be included in the Local Government Tort Claims Act.

Prince George's County Student Loan Refinancing Authority

During the 2017 session, the Prince George's County delegation to the General Assembly sponsored legislation regarding a student loan refinancing authority in the county. House Bill 1576 of 2017 (Chapter 311) requires Prince George's County to review and study the defunct Prince George's County Supplemental Higher Educational Loan Authority that was originally authorized by the General Assembly in 1986. Very little is known about the authority; therefore, Chapter 311 requires the county to determine the functions performed, and the actions taken, by the authority while it was a functioning entity. The legislation also requires the county to determine why the authority is now defunct and to determine whether changes could be made to the authority that would enable it to be a functioning entity that meets the current needs of the county. Additionally, Chapter 311 requires the county to (1) perform a feasibility and demand study for a student loan refinancing program in the county; (2) assess the potential benefit to recruitment and retention of county and school system employees of a student loan refinancing program in the county; (3) study the operation of student loan refinancing programs in other systems, including operating costs; and (4) hold public hearings on a student loan refinancing program in the county and provide an opportunity for public comment.

The study must be completed on or before December 1, 2018, and the provisions of Chapter 311 are set to terminate on June 30, 2019. As of September 29, 2017, the study had not begun.

Maryland Higher Education Supplemental Loan Authority

In 1982, the Maryland General Assembly established the Maryland Higher Education Supplemental Loan Authority (Chapter 488) as an 11-member public instrumentality to provide an alternative and supplemental source of education loans for students attending Maryland institutions of higher education. The program was targeted to serve the needs of families who did not qualify for federal programs or needed more aid than was available through federal programs. The authority made loans to students and the parents of students who were enrolled in participating institutions. At its peak, 10 nonprofit institutions participated in the program. Although the law authorized public institutions to participate in the program, none did.

In 1984, the authority issued its first tax-exempt revenue bonds and the proceeds were loaned out over a period of three years. During the 1984-1985 academic year, the authority provided $2.2 million in education loan funds to 255 borrowers at an initial interest rate of 11.75%. Loan recipients could borrow from $2,000 to $12,000 annually. For the 1984-1985 academic year, the majority of the education loans were provided to families with incomes between $40,000 and $70,000, although 10% of borrowers had family incomes above $100,000. Almost half of the loan recipients were Maryland residents. Adjusted for inflation to today's dollars, the loans ranged from $4,700 to $28,200, and the majority of loans were provided to families with incomes between $94,000 and $235,000.

In the late 1980s federal law and regulations were altered to significantly restrict the issuance of tax-exempt debt, which caused solvency issues for the authority. This was further compounded in 1991 when the authority learned of two problems that could have an adverse impact on its education loan program: (1) a disproportionate increase in the loan prepayment rate for the 1990-1991 period compared to the previous year, which likely signaled future deficits in the program; and (2) the crisis in the banking industry, which adversely affected the provider of the credit facility supporting the authority's bonds. The authority hired a consultant to develop proposals to address these potential problems and one of the solutions recommended by the consultant was to sell the authority's student loan portfolio.

In February 1992, the authority voted unanimously to sell the authority's student loan portfolio. The authority's offices officially closed on June 30, 1992, and the authority was defunct until it was repealed by the Budget Reconciliation and Financing Act of 2003 (Chapter 203).

Chapter 3. Overview of Student Debt

Student Loan Debt Nationally

Debt Continues to Increase

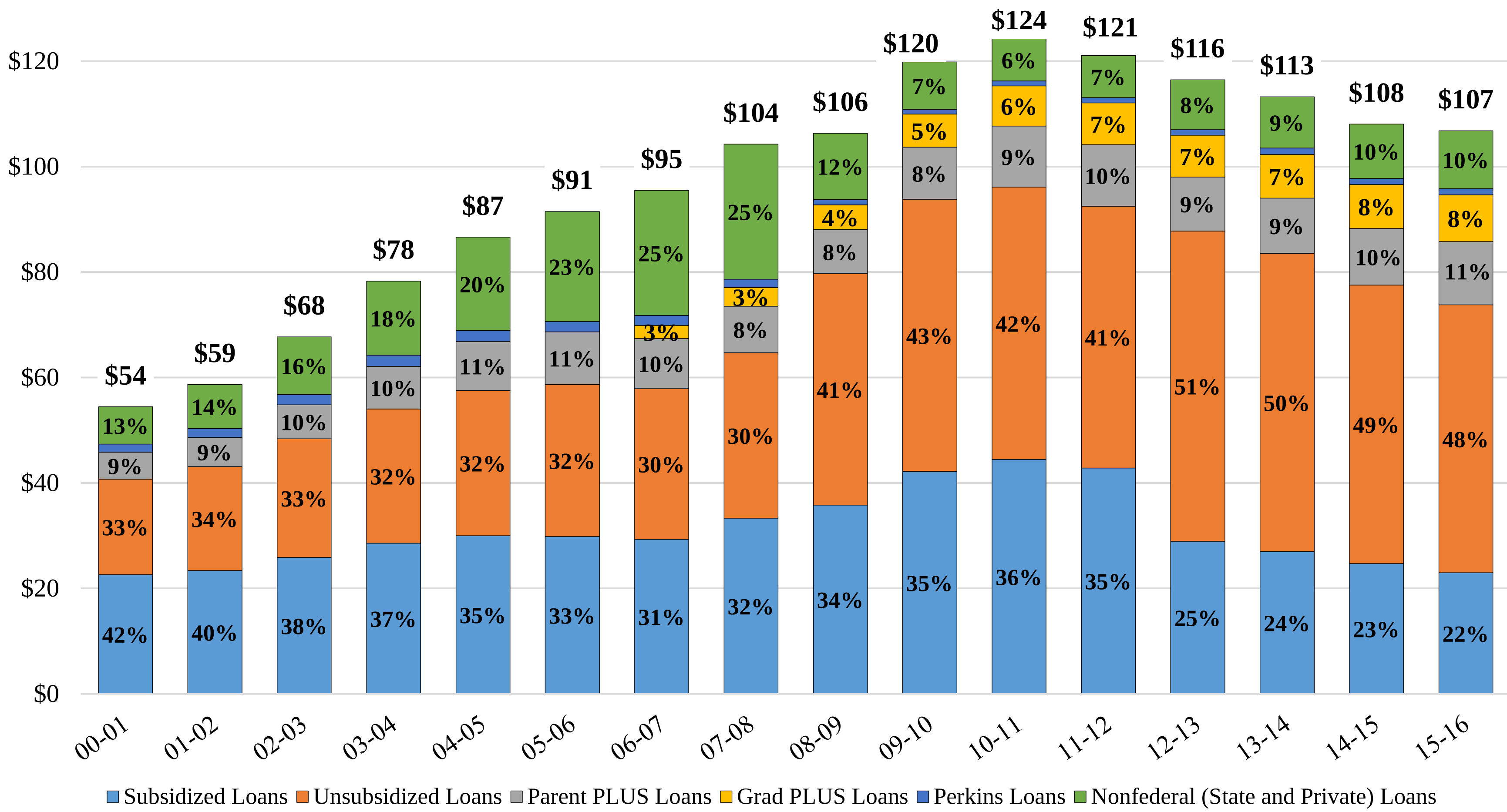
A complete picture of student loan debt is not available. While there is reasonably detailed information on federal loans and student loan debt at public and nonprofit institutions, information on private loans and student loan debt at for-profit institutions is relatively limited. However, based on all available data, student loan debt continues to increase steadily over time. According to data from the Federal Reserve Bank of New York, the estimated aggregate balance of student loans reached $1.3 trillion in 2016, up from $482 billion a mere decade earlier. Student loan debt is not restricted to any single age group: the debt is split into roughly equal thirds between individuals younger than age 30; individuals age 30 to 39; and individuals age 40 or older.

Most Student Loans are Federal

In the aggregate, *annual* student loan borrowing peaked in 2010-11 at $124.2 billion. **Exhibit 3.1** shows the annual amount borrowed by loan type. The federal government is the primary lender for student loans and offers a variety of loans to students and parents, including subsidized loans, which do not accrue interest while a student is enrolled, unsubsidized loans, and PLUS loans, which are for parents and graduate students. Perkins loans are low-interest loans for undergraduate and graduate students with exceptional financial need. Even though it is a federal program, the loan is made by the school. Nonfederal loans (direct State loans and private loans) as a proportion of total loans peaked in the mid-2000s at 25% and have since decreased to about 10% of new loans annually.

For federal loans, the type of borrower (undergraduate, graduate, or parent) determines the interest rate for the loans, as shown in **Exhibit 3.2**. Rates have historically been higher for graduate students and parents. Nonfederal loans have rates determined by the state program or private lender.

Exhibit 3.1
Annual Federal and Nonfederal Student Loans (Billions of 2015 Dollars)
2000-2001 to 2015-2016



Source: *Trends in College Pricing.* © The College Board.

Exhibit 3.2
Interest Rates for Federal Student Loans, By Type and Year

Undergraduate	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Subsidized	6.8%	6.8%	6.0%	5.6%	4.5%	3.4%	3.4%	3.9%	4.7%	4.3%	3.8%	4.5%
Unsubsidized	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	3.9%	4.7%	4.3%	3.8%	4.5%
Graduate												
Subsidized	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	-	-	-	-	-	-
Unsubsidized	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	5.4%	6.2%	5.8%	5.3%	6.0%
Graduate/Parent												
PLUS Loans	7.9%	7.9%	7.9%	7.9%	7.9%	7.9%	7.9%	6.4%	7.2%	6.8%	6.3%	7.0%

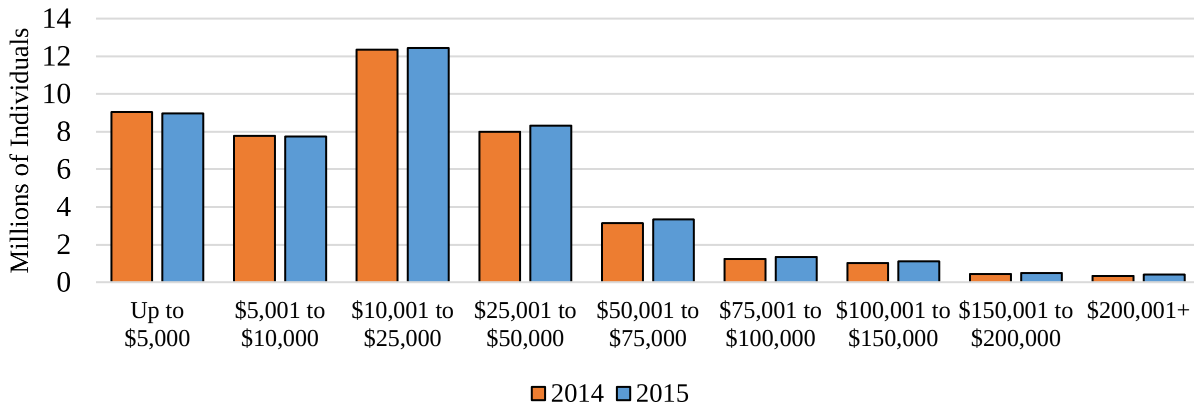
Notes: Interest rates for each year (July 1 through June 30 of the listed year) are fixed for the duration of the loan. Separate loan programs with identical interest rates have been condensed. Additional "Federal PLUS" loans were also available to graduate students and parents through June 30, 2010, at 8.5% interest. Subsidized loans do not accrue interest while a student is enrolled. Most loans disbursed prior to July 1, 2006, have variable interest rates that change each year.

Source: U.S. Department of Education

Most Borrowers Owe Less than $25,000

The Federal Reserve Bank of New York maintains an estimate of the distribution of student loan debt. As shown in **Exhibit 3.3**, in 2014 and 2015, about two-thirds of all individuals with student loan debt owed less than $25,000 while only about 5% of individuals owed more than $100,000.

Exhibit 3.3
Student Loan Debt by Total Balance
2014 and 2015



Source: Federal Reserve Bank of New York Consumer Credit Panel; Equifax

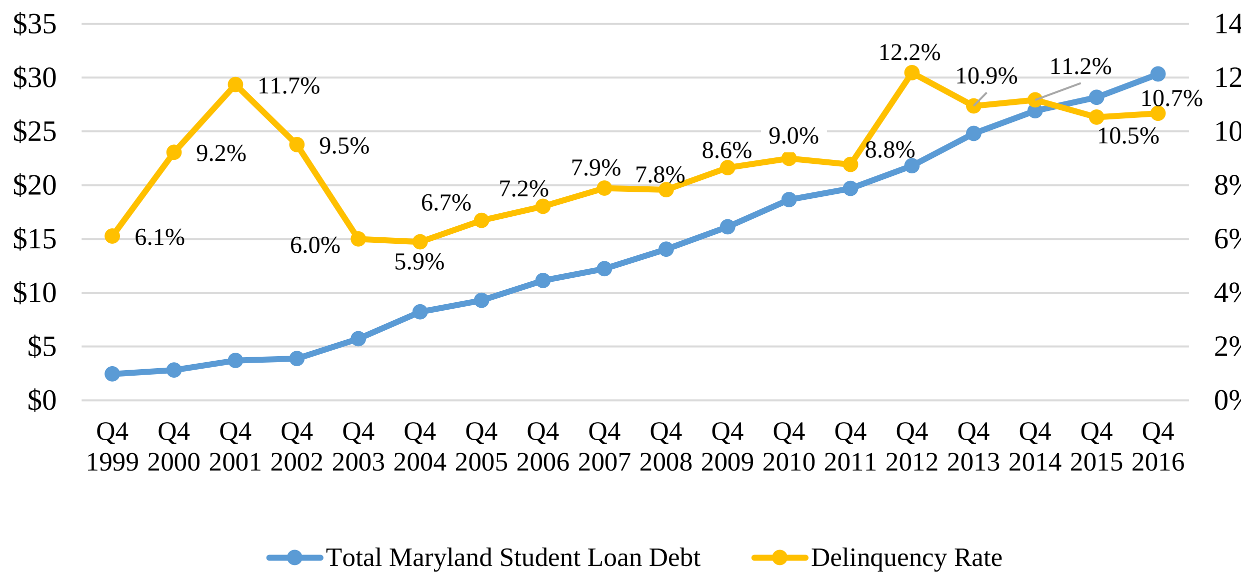
Student Loan Debt in Maryland

The broader data issues inherent in national student loan debt information are also present at the state level. The student loan data presented below is general in nature and is not specific enough to determine the actual demand for a student loan refinancing program in Maryland. One of the recommendations of this report is a consultant study to analyze, among other things, demand for a program in Maryland.

Maryland Debt and Default Rates

The Federal Reserve Bank of New York estimates Maryland's aggregate student loan debt increased from $2.4 billion in 1999 to $30.3 billion in 2016 – or about 16% annually on average – which is slightly higher than the national growth rate during that time. The delinquency rate on the debt also increased steadily during much of that time, as shown in **Exhibit 3.4**. According to data maintained by the Institute for College Access & Success, 56% of 2015 graduates from Maryland's undergraduate institutions had student debt with an average debt (of those with loans) of $27,672. This is more than double the average debt of 2004 graduates. Relative to other states, 35 have a higher percentage of students graduating with debt than Maryland, and 27 have higher amounts of average debt.

Exhibit 3.4
Maryland Student Loan Debt and Delinquency Rate, 1999-2016
($ Billions)



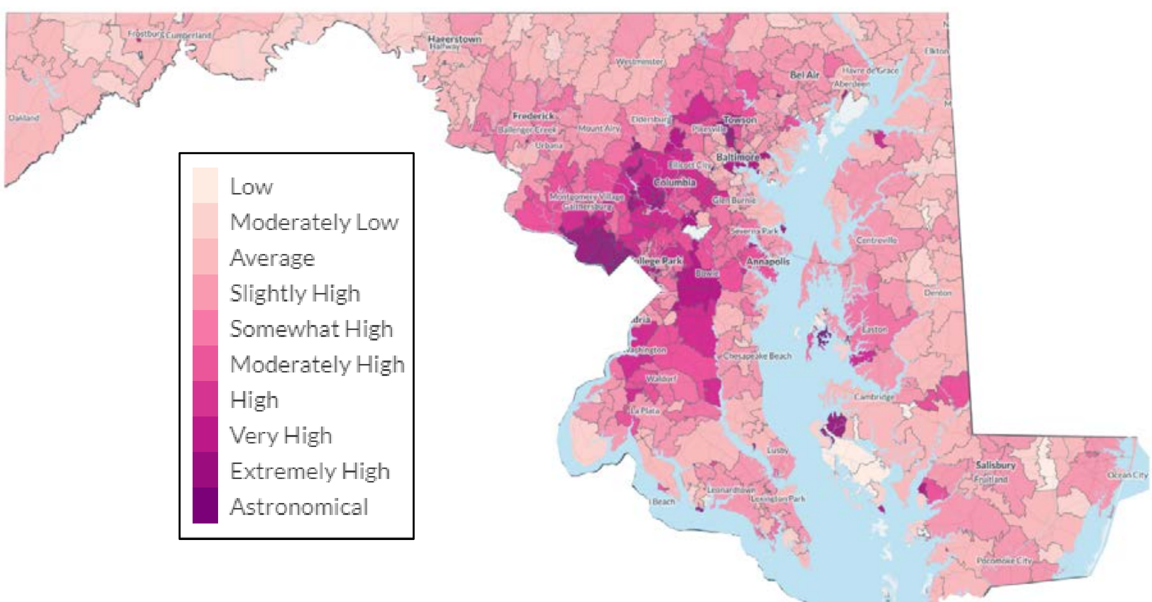
Source: Federal Reserve Bank of New York Consumer Credit Panel; Equifax

Student Debt Balances and Delinquencies Show Substantial Geographic Variation

The Mapping Student Debt Project conducted by the Washington Center for Equitable Growth uses credit data from Experian to map average student debt levels and delinquencies in 2015, as shown below in **Exhibits 3.5** and **3.6**. Relatively high loan balances are largely concentrated in Baltimore City and Baltimore, Howard, Montgomery, and Prince George's counties. However, high loan balances are not necessarily associated with high delinquency rates. In fact, except for parts of Baltimore City and parts of Montgomery and Prince George's counties, the opposite appears much more common.

The project acknowledges some underlying issues with the data. For example, it only includes households with credit, which likely excludes some of the poorest households. Loans with multiple signatories might also be accounted for in multiple counties. Further, the project does not report absolute delinquency rates, instead only showing relative differences. For these reasons, among others, **Exhibits 3.5** and **3.6** should be used *for general informational purposes only* and not as a substitute for a market demand study, which is discussed in Chapter 1 of this report.

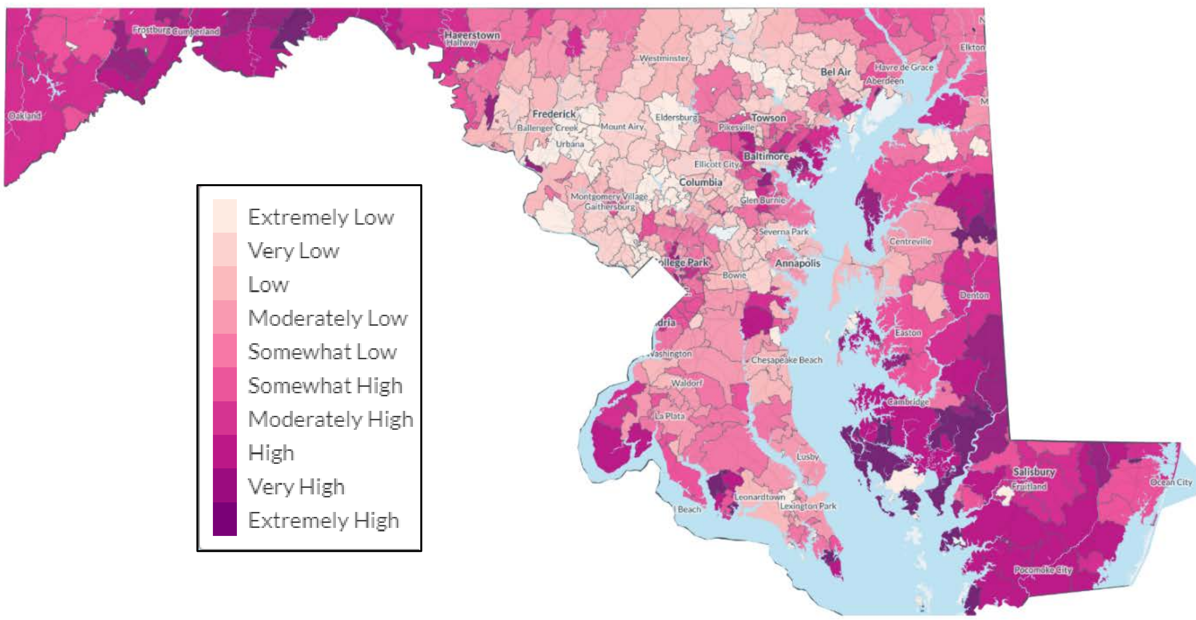
Exhibit 3.5
Average Loan Balance, by Zip Code
2015



Note: Loan balance categories are relative to a national average of $24,271. The "Low" category is 70% or less of the average ($16,990). The "High" category is 45% to 55% more than the national average ($35,193 to $37,620). "Astronomical" is any amount more than double the national average ($48,542).

Source: Mappingstudentdebt.org

Exhibit 3.6
Relative Delinquency Rate, by Zip Code
2015



Note: Due to concerns with the data, delinquency rate categories are relative to each other and do not necessarily relate to any specific value.

Source: Mappingstudentdebt.org

Existing Repayment Options for Student Loans

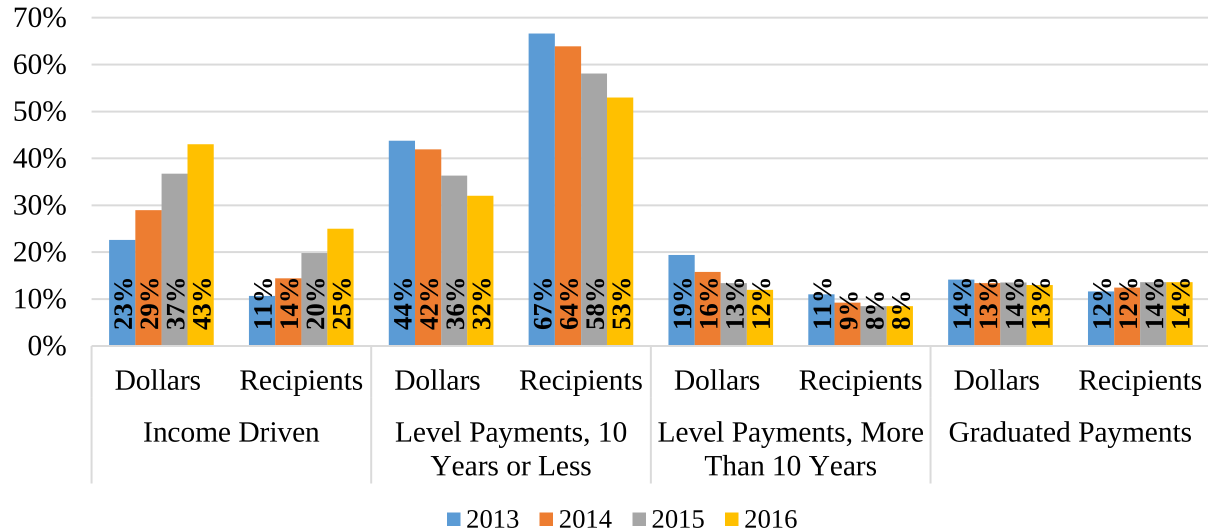
Federal Loans Offer a Variety of Repayment Plans, but No "Refinancing"

Standard federal student loans include a 10-year loan repayment plan. From there, depending on eligibility, the borrower may enroll in a variety of different repayment options. Broadly, in addition to the standard 10-year repayment plan, there are income-driven plans, extended level payment plans, and graduated payment plans. Income-driven plans cap monthly payments based on income and family size, which are generally 10% to 20% of discretionary income depending on the particular program. After a period of time, which ranges from 10 years to 25 years, depending on the program, any remaining balance is eligible for forgiveness. Level payment plans require monthly payments that are the same over a period of time, while graduated payment plans start with lower monthly payments that increase over time. **Exhibit 3.7** shows the distribution of the federal loan repayment plans by both dollars and recipients from 2013 through

2016. The strongest trend present in the data is the increasing use of income-driven repayment plans. By 2016, 25% of all borrowers, representing 43% of all loan balances, were enrolled in an income-driven plan.

Federal loans can be consolidated into a federal single loan; however, the interest rate on the consolidated loan is the weighted average of the interest rates on the underlying loans. There is no federal program providing for the "refinancing" of federal loans at a better interest rate.

Exhibit 3.7
Distribution of Outstanding Federal Direct Loan Dollars and Recipients by Repayment Plan



Notes: Income-driven plans include Revised Pay-As-You-Earn (REPAYE), Pay-As-You-Earn, Income-Contingent Repayment, and Income-Based Repayment. Level payment plans require monthly payments that are the same over 10 years or a different period of time. Under the graduated payment plan, monthly payments increase over time. Percentages may not sum to 100 because of rounding.

Source: *Trends in College Pricing.* © The College Board.

Maryland Loan Repayment Programs

The State has five loan assistance repayment programs that provide various levels of assistance to qualifying individuals, as described in **Exhibit 3.8**. A total of $2.9 million in loan repayment assistance was appropriated for these programs in fiscal 2018.

Exhibit 3.8
State Student Loan Assistance Repayment Programs

Janet L. Hoffman	Loan repayment assistance for graduates of an institution of higher education in Maryland who work full-time for the government or the nonprofit sector in a priority field as determined by the commission. Priority is given to recent graduates who are State residents and employed full-time principally providing legal services to low-income residents, nursing services in nursing shortage areas in the State, or other employment fields where there is a shortage of qualified practitioners for low-income or underserved residents. Recipients must meet income eligibility requirements.
Nancy Grasmick Teacher Scholars (Part of Hoffman Program)	Loan repayment assistance for those who currently serve in specified public schools or teach science, technology, engineering, or math and graduated from a Maryland university.
Primary Care Physicians and Physician Assistants	Loan repayment assistance for those who currently serve or who pledge to serve as primary care physicians and physician assistants.
Maryland Dent-Care	Loan repayment assistance designed to increase access to oral health services for Maryland Medical Assistance Program recipients.
Foster Care Recipients	Loan repayment assistance designed to increase higher education access for students who received foster care assistance (new in fiscal 2018).

Source: Department of Legislative Services

Existing Refinancing Options

Private Companies

There are several private companies that refinance student loans. These companies compete directly with state government refinancing programs and each other. Examples include SoFi, CommonBond, LendKey, and Citizens Bank. Private companies typically offer fixed and variable rate products and a range of repayment terms from 5 to 20 years. Advertised rates as of September 2017 ranged from 2.79% to 8.13% for variable rates and 3.25% to 8.24% for fixed rates. Minimum acceptable credit scores are typically about 660.

State Refinancing Programs

At least 14 other states have student loan refinancing programs, as shown in **Exhibit 3.9**. Of those, at least three currently offer refinancing to Maryland residents. As discussed further in Chapter 4 of this report, most state refinancing programs are relatively new and all have been added to existing entities. Further, except for Louisiana, which ceased offering student loans in 2010, all other states that currently refinance loans also offer student loans. Borrower eligibility requirements usually include residency in the state or a nexus to the state and minimum creditworthiness standards (see **Exhibit 4.1** in Chapter 4).

Exhibit 3.9
State Student Loan Authorities with Refinancing Programs, and Loan Types Offered

	Authority	Loan Types
Alaska	The Alaska Commission on Postsecondary Education	Student, Refinance, Family
Connecticut	Connecticut Higher Education Supplemental Loan Authority	Student, Refinance
Indiana	Invested Indiana	Student, Refinance
Iowa	Iowa Student Loan	Student, Family, Refinance
Kentucky	Kentucky Higher Education Student Loan Corporation	Student, Refinance, Parent
Louisiana*	Louisiana Education Loan Authority	Refinance*
Maine	Finance Authority of Maine	Student, Refinance
Massachusetts	Massachusetts Educational Finance Authority	Student, Refinance
Minnesota	Minnesota Office of Higher Education	Student, Refinance
New Hampshire	New Hampshire Higher Education Loan Corporation	Student, Refinance
New Jersey	Higher Education Student Assistance Authority	Student, Refinance,
North Dakota	Bank of North Dakota	Student, Refinance
Rhode Island	Rhode Island Student Loan Authority	Student, Refinance, Parent
South Carolina	South Carolina Student Loan	Student, Refinance, Parent

* Louisiana ceased offering new student loans in 2010 but continues to maintain a portfolio of loans issued prior to that time.

Notes: Student loans may still require the student to have a cosigner. Parent and family loans can be made directly to individuals other than the student.

Source: Department of Legislative Services; state program websites

Chapter 4. Other States

Survey of State Programs

To gain a better sense of other state programs, the Department of Legislative Services (DLS) surveyed 10 states with recent student loan refinancing programs (a sample survey can be found in **Appendix 1**). States known to have student loan refinancing programs were chosen based on their potential relevance to a Maryland program. The survey asked questions about the refinancing program, the bond issuer, eligibility requirements, start-up and ongoing funding, loan terms, underwriting requirements, and perceived best practices.

Not all programs answered all questions. DLS received eight responses that were mostly or entirely complete (Connecticut, Kentucky, Louisiana, Massachusetts, Minnesota, New Jersey, Rhode Island, and South Carolina), while Indiana indicated that it did not have time as a new program and New Hampshire did not respond. In addition to the above survey questions, DLS also asked for bylaws, a recent official statement or other offering document, program marketing materials, recent audited financial statements, and any other information thought to be useful.

As previously discussed, Montgomery County's Office of Legislative Oversight (OLO) also recently conducted a study on student loan refinancing programs. Information from that study, which was released during the DLS survey process and surveyed the same states, among others, has been used to supplement the DLS survey responses (and noted where applicable).

Survey Findings

Refinancing programs have typically been added to existing loan programs. All eight of the state programs that responded to the DLS survey indicated that their refinancing programs were part of a larger, mature program, typically another form of direct lending. For example, the Massachusetts Educational Financing Authority has provided student loans since the early 1980s, has operated the state's 529 plan since the early 2000s, and began offering refinancing in 2016. Many of the other state programs are similar. Neither the DLS survey nor the Montgomery County OLO report found a standalone refinancing program.

Most refinancing programs are relatively new. Generally, state refinancing programs are a relatively recent development. The Rhode Island program – established in 2014 – was the oldest program to respond to the DLS survey. The Kentucky and South Carolina programs were established in 2015, and the remaining five programs were established in 2016 or 2017. South Carolina noted that it previously had a refinancing program in the mid-2000s, but suspended it during the credit crisis, which began in 2008.

Eligibility typically is determined by residency and creditworthiness. Borrower eligibility requirements usually include residency in the state or a nexus to the state and minimum creditworthiness standards (credit scores, other debts, and income). Most states require a borrower to have a nexus to the state because a program financed with tax-exempt bonds is authorized by the Internal Revenue Service to refinance student loans only for borrowers who have a nexus to the state (*e.g.*, state residents or nonresidents who attended an institution of higher education in the state). The state programs that do not require a nexus to the state are financed using a mix of nontax-exempt bonds and tax-exempt bonds.

Of the programs that publish minimum credit scores, the minimum acceptable range is in the high 600s to low 700s, which is consistent with the minimums required by private companies. For context, nationally, slightly more than half of all FICO scores were 700 or higher in April 2017. **Exhibit 4.1** summarizes some of the specific eligibility requirements for the states that responded to the DLS survey.

Exhibit 4.1
Select Eligibility Requirements for Student Loan Refinancing

State	Residency Requirement	Employment or Required Minimum Income	Minimum Credit Score	Maximum Debt-to-Income Ratio
Connecticut	State resident; nonresidents with student loans through the Connecticut Higher Education Loan Authority.	No minimum income level.	Acceptable FICO scores, as determined via a TransUnion credit report.	43%
Kentucky	Residents of 38 states (including Maryland), with plans to expand to all 50 states.	Borrower must have an income of $1,500/month. If the loan requires a cosigner, the cosigner must have an income of $2,000/month.	670 FICO score for both the borrower and cosigner.	38%
Louisiana	State residents.	Borrower must have an annual income of at least $25,000.	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 history of other credit-negative events.	40% (25% excluding mortgage or rent)
Massachusetts	A U.S. citizen or permanent resident.	Borrower must have an income of at least $24,600 annually.	No published minimum FICO score. Must have 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	State residents.	Borrower must be currently employed with the same employer for at least 60 days.	700 FICO score and no delinquencies on loans.	45%
New Jersey	State residents, current nonresidents that incurred debt while residents, and attendees of higher education institutions in the State.	Borrower must have an annual income of at least $40,000.	670 FICO	40%
Rhode Island	Borrowers who reside in any state (potential for lower interest rates for Rhode Island residents).	Borrower must have an income of at least $40,000.	680 FICO score and meets credit criteria for loan approval.	50%
South Carolina	State residents.	Borrower must be employed.	675 FICO score and meets credit criteria for loan approval.	30%

Source: Department of Legislative Services; State program websites and conversations with program staff; Tables 1-2 and 1-3, Montgomery County's *Student Loan Refinancing Authority (OLO Report 2017-2018).*

Best Practices and Lessons Learned from Other States

Programs indicated the need for existing expertise, program flexibility, effective marketing, and customer service. The DLS survey requested any "best practices" and "lessons learned" for running a successful student loan refinancing program. Full written responses are included below where possible (Massachusetts responded via telephone). Both Kentucky and Massachusetts discussed the importance of debt issuance and loan program expertise – citing the help that decades of experience provided when establishing a new refinancing program. Minnesota stressed the need for flexibility to ensure that a program can continue to grow and adapt to change. Rhode Island, Massachusetts, and South Carolina each emphasized the importance of marketing the program. Rhode Island also mentioned the importance of customer service.

Kentucky: "A best practice for running or developing a program is to leverage the significant years of experience in loan program administration as well as reaching out to experts in a highly complex and regulated field and marketplace. [The Kentucky Higher Education Student Loan Corporation and the Kentucky Higher Education Assistance Authority] were fortunate to have decades of experience in the origination, disbursement and management of student loans. The organization previously was responsible for more than $1B in annual originations and leveraged that extensive experience and infrastructure to set up the program."

Minnesota: "The legislature authorized the program and set the $70,000 maximum loan limit per borrower; however, we were allowed the flexibility to determine specific eligibility criteria. This flexibility recently allowed us to modify our eligibility criteria based on the information we gathered from the first year of the program in terms of credit scores and debt-to-income ratios of some of the loans that were denied. We were able to loosen criteria which will allow more people to qualify. With a new program you don't know what kind of interest there will be in the program, how attractive your program will be and the characteristics of the people being approved and denied. Having flexibility allows eligibility requirements to be modified as you learn more about your applicants. Since the program is so new we haven't seen any defaults. Flexibility also would allow us to make changes if we started seeing unfavorable trends related to defaults."

Rhode Island: "[The] [m]arket is divided between borrowers who want either lower monthly payments or lower overall debt service. Borrowers who want lower monthly payments tend to have higher debt levels relative to their income and need to extend the payment term to make the debt more affordable for them. Borrowers who want lower overall debt service tend to have long term personal financial goals and see refinancing as a tool to help them achieve those goal[s]."

"Customer service is very important. Making the terms of the program easy to understand on the web site, providing help and excellent customer service through the application, disbursement, and repayment servicing process are all critical for a successful program."

South Carolina: "We began the program by purchasing a list of PLUS loan borrowers from the credit bureau as we know those borrowers have an interest rate that is higher than what our refi program offers. We should have combined this with a marketing program to include social media, Google leads, etc. We are now implementing these marketing features but should have done it earlier."

"Make sure that you have researched all of the interest rates being offered by other lenders and in setting your rates be sure to have tiered rates based on creditworthiness. Also, perform a cash flow analysis with assumed cost of funds and assumed default losses to ensure that you have sufficient excess spread. This will be necessary to obtain bond ratings and attract investors."

Most programs do not break out operating costs specifically for refinancing. As discussed above, student loan refinancing programs have been added to existing loan programs that have each grown and changed organically over time. States surveyed by DLS indicated that they do not track operating costs between their different programs. Louisiana was the only state to respond to DLS with an estimated cost specific to its refinancing program. It estimated about $140,000 to $175,000 in initial start-up costs, which were mostly legal fees related to bond issuance and do not include any amount associated with a cash default reserve. No new staff were hired for the Louisiana program; instead, existing staff assumed responsibility for implementation. A discussion of potential costs for a Maryland program can be found in Chapter 5 of this report.

Some other states' programs are open to nonresidents. Student loan refinancing programs in Massachusetts and Rhode Island are open to borrowers who reside in any state and the Kentucky program is open to residents of 38 states, including Maryland. Connecticut allows nonresidents who have student loans through the Connecticut Higher Education Loan Authority to participate in the program. New Jersey allows nonresidents who incurred debt while residents and attendees of an institution of higher education in the state to participate in the program. Currently, Maryland residents may participate in the student loan refinancing programs in Massachusetts, Rhode Island, and Kentucky, and that number is likely to increase over time as the trend is expanding programs to allow other states' residents to participate.

Chapter 5. Essential Characteristics of a Successful Student Loan Refinancing Program and Other Considerations

State student loan refinancing programs are generally funded through the issuance of bonds, either on a tax-exempt basis (if certain conditions are capable of being satisfied under the federal tax laws) or on a taxable basis, the proceeds of which are used to pay off a pool of students' loans. Otherwise, a State program would be forced to rely on other sources of funds (*e.g.*, State general funds) to refinance the student loans, which is likely untenable in the current budgetary environment and would crowd out funding for other budgetary priorities. Therefore, affordable access to debt financing with which to provide the funds to refinance student loans is essential. According to written reports from various bond rating agencies, the principal criteria they use to rate bonds issued for student loan programs include (1) the quality of the bond issuer and any firms providing loan origination and servicing, which impact the evaluation of the operational risks of the program; (2) the credit enhancement for the program; and (3) the strength of the underlying collateral pool, consisting of the refinancing loans.

In the absence of a market-specific study, it remains unclear as to whether establishing a State student loan refinancing program is advisable. However, *if* the State determines that a student loan refinancing program should be started in Maryland, based on the underlying necessity for affordable access to debt financing, the following characteristics, at a minimum, are essential:

- the program must be administered by an experienced bond issuer;
- credit enhancement, in the form of cash default reserves, must be provided initially so that refinancing rates are attractive to borrowers;
- funding for start-up and operating costs must be provided until the program is self-sustaining; and
- the program must have the flexibility to adapt to changing market conditions.

Additional considerations related to program goals, credit enhancements, and private activity bonds are included at the end of this chapter. For a description of the entities best suited to serve as the issuer for a student loan refinancing program in the State, see Chapter 6.

A Successful Program Must be Administered by an Experienced Bond Issuer

As described above, affordable access to debt financing is the underlying essential requirement for a successful student loan program. Capital debt markets and their related laws are, to put it mildly, complicated. Therefore, a successful program should be administered by an existing bond issuer with skill and experience in debt structuring, securitizing loans through pooled financings, managing debt portfolios, investing bond proceeds, and accessing the public capital markets. The issuer and its advisors should also be well-versed in the tax rules with respect to tax-exempt bonds and post-issuance compliance matters with respect to bond issuances. This kind of experience is gained principally as a result of the frequency with which the bond issuer sells bonds into the capital markets and the active involvement of the issuer in the pricing and sale of the bonds.

Bond Issuer Experience and Reputation are Particularly Important with Student Loans

Bond rating agencies assess the operational risk of student loan refinancing programs in part on the basis of an evaluation of the bond issuer. Unlike other revenue bonds which are payable from the revenues of the project financed or amounts paid by ultimate recipients of the bond proceeds, student loan refinancing bonds are payable from payments made under student loans that are bundled and sold into the capital markets by the program sponsor. The underlying loans comprise the assets of the program which over time may be leveraged as collateral to secure future bond issues. Thus, experienced management of the program is required to assure the ultimate repayment of the bonds.

In order to meet the rating agencies' expectations, a bond issuer should have a governance structure that provides management oversight and a process for authorizing certain material matters with respect to the program and otherwise provides guidance on the program. In addition, the bond issuer should maintain strong administrative controls with respect to the oversight of the administration and servicing of the loans. Management of the bond issuer is also critical to ensure that appropriate financial and operational controls are in place as well as the necessary policies and procedures.

Staffing Considerations for the Bond Issuer

The bond issuer should be staffed with qualified personnel to, among other things, review the loan applications, assist in the loan underwriting process, retain and manage the professionals engaged by the issuer (including the entity or entities servicing the loans in addition to bond counsel and financial advisors required for the bond issues), manage the investment of the bond proceeds prior to their use to refinance loans and oversee post-issuance compliance matters.

In addition to administering the program, the staff could include loan counselors to provide borrowers with information concerning, among other things, the loan options available, including repayment options, the interest rates, and the loan terms. Alternatively, loan origination and counseling services could be out-sourced to a third party.

The federal government's student loan program has an ombudsman that assists with collection practices, consolidation, credit reporting, loan defaults, repayment plans and other issues concerning the loans. Having an ombudsman may assist borrowers with the proper loan management, thereby keeping loans from reaching default.

Initial Funding for Credit Enhancements and Operating Expenses Will Be Necessary

As a start-up loan refinancing program, Maryland's program would lack the benefit of an existing loan portfolio that could be leveraged to collateralize the initial refinancing loans and fund ongoing operations. Therefore, significant funding will be needed to establish a cash default reserve fund, which is a type of credit enhancement, and for start-up costs. While these costs could largely be "self-funded" by issuing additional debt, doing so could cause the interest rate on the bonds to increase to a level that makes a refinancing program unattractive to potential customers.

Cash Default Reserve

The required size of the cash default reserve will depend upon several factors, including the size of the initial bond offering and the risk profile of the loans eligible for the program. Generally, the more restrictive the program in terms of the types of loans and the income, credit score, and other requirements with respect to the creditworthiness of the borrower, the lower the reserve requirement.

Based on preliminary estimates provided by investment banking firms that underwrite student loan bond offerings, the required cash default reserve for an initial bond offering would be approximately 25% to 30% of the principal amount of bonds being offered. For example, a bond offering that includes $10 million of funds to refinance loans would require a cash default reserve of approximately $2.5 million to $3.0 million, which could be provided from outside sources (*e.g.*, the State) and/or by increasing the total bond offering. In this example, without outside funding, the total bond offering would increase to approximately $12.5 to $13.0 million. About 400 loans could be made to borrowers in such an offering assuming that each loan was approximately $25,000.

Depending on market conditions, the cash default reserve may be funded with a portion of the bond proceeds. However, doing so could cause the interest rate on the bonds to increase to a level that makes the interest rate being offered to the borrowers noncompetitive when compared to other funding sources. This could, in turn, cause an overall decrease in demand for the loans being offered as borrowers would view the rates offered as too high as compared to other lending options. As a result, as part of the recommendations included in this report, a consultant should study the amount of cash the State would need to contribute to the program to ensure that it is competitive in the marketplace. Over time, as the program matures, the amount of the default reserve fund may be reduced or may not be necessary if the program is over-collateralized or otherwise establishes a solid reputation in the marketplace.

Any cash contribution made by the State to fund a default reserve could be repaid over time. In such event, the repayment obligation would be subordinate to the payments due to the bondholders and would depend upon the success of the program and consequently, the ability of the program to self-fund any future cash reserves.

Other Start-up and Operating Costs

In addition to funding a cash default reserve, other start-up costs are likely in the range of $200,000 to $400,000 and ongoing annual operating costs could range from $0.5 million to $1.0 million annually, depending on the size of the program. These estimates are based on the costs of the Rhode Island, Louisiana, and Connecticut programs. Actual costs may vary significantly depending on the details of the program. These costs will need to be funded through other means until a self-funding loan portfolio is attained. Research by Montgomery County's Office of Legislative Oversight (OLO) indicates that programs can become self-funded in 3 to 10 years. If initially paid by the State, these costs could also be repaid over time as the program becomes self-funding. This has happened several times with new State programs. For example, the Maryland Health and Higher Educational Facilities Authority and the Maryland College Savings Plan (now Maryland 529) received loans from the State that were subsequently repaid.

OLO selected programs of three states having characteristics most similar to Montgomery County (Rhode Island, Louisiana, and Connecticut) and calculated their annual operating costs. The Rhode Island Student Loan Authority has nine in-house staff and annual operating costs of $1,028,000. The Louisiana program had initial operating costs of $175,000, but cannot determine its annual operating costs until after its first year of implementation as it was using existing staff during the ramp-up period. The Connecticut Higher Education Supplemental Loan Authority has a small staff for both a student loan and a refinancing program and mostly contracts for services. The Executive Director of the Connecticut loan programs is also the Executive Director of the Connecticut Health and Educational Facilities Authority and manages the loan programs under a management agreement between the two organizations. Annual operating costs for the Connecticut loan program are $779,000.

Flexibility Will Allow the Program to Adapt

Student loan refinancing programs are still relatively new and the market for loan refinancing is likely to change over time as interest rates adjust and programs enter and exit the marketplace. The program should be structured to allow significant flexibility to adapt over time as the program evolves in response to market changes and fluctuations in cost and to otherwise achieve the goals and policies established by the State.

Other Considerations

Program Goals and Underwriting Criteria Will Affect Overall Program Viability

The program goals will in substantial measure dictate the loan eligibility requirements, the need for and prospects for the success of a State loan refinancing program, and the amount of default reserves or other collateral necessary to sell bonds to fund the program at the lowest interest rates. Possible goals include:

- generally reducing the debt burden of individuals having outstanding student loans (generally improving health and welfare of residents);
- increasing home ownership and otherwise enhancing the State's economy by reducing monthly payments, thereby creating extra cash to be pumped back into the economy;
- assisting low-income families or other targeted groups, such as veterans; and
- attracting and retaining residents with particular skills or seeking employment as teachers, police officers, firefighters, or other public service-oriented professions in the State.

Lowering the creditworthiness standards for the borrowers and co-signers will broaden access to the program, but will also result in a riskier loan portfolio and higher interest cost and greater need for collateral. For example, performance data compiled by bond rating agencies indicate that loans for graduate and professional schools have a lower default rate than those for undergraduate schools. As such, a program goal of assisting borrowers that have undergraduate degrees and a weaker credit profile may provide an opportunity that otherwise might not be available for that group of borrowers to refinance their loans at a lower interest rate, but may also increase the cost of the program.

Once the goals of the program are established, appropriate underwriting criteria can be determined. According to published reports by the bond rating agencies, the underwriting criteria may include requirements such as:

- the type of school attended by the students whose loans are refinanced, whether four-year, two-year, or proprietary/vocational and whether for-profit or nonprofit;
- the program type, graduate, undergraduate, associate, vocational or professional, and whether the student must have obtained a degree or certificate;
- whether the loan is co-signed;
- the employment status of borrower and any co-signers;
- the income and the size of the loan payments as a percentage of the income of the borrower and any co-signers; and
- the credit scores of the borrower and any co-signers.

Types of Credit Enhancements for a Start-up Program Over Time

There are a variety of ways to provide credit enhancement for bonds issued to finance a pool of student loans, including funding substantial cash default reserves, providing government guaranties, over-collateralization, and the structure of the bond issuance itself. Since a Maryland program would be a start up and would not have any assets in the form of existing loans or cash raised through the spread in the interest rates on prior loans over the interest on the bonds and related expenses, initial credit enhancement will need to be provided through cash default reserves. As described above, the amount that may be needed to fund an initial default reserve ranges from 25% to 30% of the principal amount of the initial loan portfolio being refinanced with bond proceeds. As the program matures, the level of cash reserves could be reduced through the use of other credit enhancements, such as a more limited government guaranty and over-collateralization.

As a student loan program develops a portfolio of loans, over-collateralization can be provided through the spread of the loan interest rate over the interest on the bonds and the costs of the program. The amount generated through the spread in the loan interest rate in any year can be used to refinance additional student loans in subsequent years, create larger cash default reserves, or both. This has been the case with other states' student loan refinancing programs, which are all off-shoots of other loan programs.

Finally, the structure of the bond issue itself may also provide a form of credit enhancement when a bond issue includes a class of senior bondholders and a class of subordinate bondholders. The strength of the program also could be enhanced by providing special collection tools to the issuer, including the ability of the issuer to intercept borrowers' tax refunds to apply to the payment of the borrowers' defaulted loans. Other State agencies that issue bonds have adopted a similar credit enhancement model. For example, one of the credit enhancement tools utilized by Maryland Community Development Administration (CDA) is the ability to redirect payments that would otherwise be made by the State to local governments to the bond trustee in the event of a default by any of the local government borrowers. The bond trustee of the CDA program applies the intercepted funds to pay debt service due to the CDA bondholders.

Private Activity Use

As a private activity use, tax-exempt bonds issued for student loan refinancing will be subject to the federal volume cap on private activity bonds. Each state receives an annual allocation of private activity bonds that may be issued on a tax-exempt basis. Maryland is currently utilizing less than its annual allocation so there should not be an issue with the availability of private activity bond allocations.

Chapter 6. Entities Best Suited to Offer a Student Loan Refinancing Program

No entity in the State has the statutory authority to issue student loan refinancing bonds. As a result, any of the entities discussed in this section would require changes to its statute in order to issue the appropriate debt and administer the program and would otherwise require staffing and operational changes in order to effectively operate the program. As previously discussed, experience and expertise surrounding the issuance of debt is essential to a successful program. Of the entities examined in this report, the Maryland Health and Higher Educational Facilities Authority (MHHEFA), with its long experience and positive reputation in the public debt markets, is the entity best suited to offer a program. Other entities with bonding authority include the Maryland Economic Development Corporation (MEDCO), the Community Development Authority (CDA) in the Department of Housing and Community Development, the Maryland Industrial Development Financing Authority (MIDFA) in the Department of Commerce, and the State's public institutions of higher education. These entities are described below, but do not appear best suited to offer the program.

Maryland 529 and the Maryland Higher Education Commission (MHEC) do not have bonding authority, but do have experience providing higher-education-related counseling and customer service; while they are not best suited to offer the program, they may be valuable partners to a State program.

Entities with Bonding Authority

Maryland Health and Higher Educational Facilities Authority

MHHEFA is an instrumentality of the State that was created to assist certain educational institutions, including institutions of higher education and noncollegiate educational institutions and health care institutions, such as hospitals and continuing care retirement communities, in the construction, financing, and refinancing of certain projects approved by MHHEFA. Such entities may issue tax-exempt bonds through MHHEFA and, thereby, pay a lower rate of interest and reduce overall debt service as compared to rates that may be offered in traditional taxable loan transactions. MHHEFA is a self-sustaining nonbudgeted agency that is funded from interest earnings on its investments and fees charged to participating borrowers throughout the life of its bond issues. Bonds issued by MHHEFA are not State debt and do not constitute a pledge of the full faith and credit of the State.

MHHEFA is authorized to perform a variety of functions for Maryland's nonprofit educational institutions and hospital institutions including (1) issuing fixed and variable rate bonds and notes; (2) financing and refinancing construction, renovation, and equipping of facilities; (3) entering into leases and subleases of projects and contracts for the operation and management of projects for the institutions; (4) making loans to participating institutions to finance projects;

and (5) establishing and administering pooled loan programs to reduce financing costs and provide enhanced access to the capital markets.

MHHEFA is governed by a nine-member board of directors, including the Treasurer of the State of Maryland (or a deputy treasurer designated by the Treasurer) who serves as an *ex-officio* voting member. MHHEFA has seven full-time staff, including an executive director, assistant director, accounting and compliance officer, and account managers. Additionally, MHHEFA contracts with professional service consultants on an as-needed basis, including bond counsel and financial advisors.

With more than 40 years of experience in issuing tax-exempt bonds, MHHEFA has a long-standing reputation in the public capital markets and has extensive experience in managing debt portfolios, investing bond proceeds, and overseeing the expenditure of bond proceeds. MHHEFA is uniquely charged with providing least cost financing to educational and health care institutions. Rather than acting as a pure conduit, MHHEFA, together with its independent financial advisor, actively participates in the pricing of each issue of MHHEFA bonds. As a result, MHHEFA is regularly in the capital markets and has knowledge of the latest strategies for obtaining the lowest interest cost on its bonds. MHHEFA advises that its fees are currently the lowest of any of the State's conduit bond issuers; therefore, MHHEFA seems well positioned to optimize the value of the funds that would be necessary to establish and operate a student loan refinancing program.

MHHEFA's expertise and positive reputation in the public debt markets along with its low fee structure make it the entity best suited to offer a student loan refinancing program in Maryland. However, while MHHEFA is authorized to issue debt for educational institutions and hospitals, its statute would need to be altered to explicitly authorize bonds for the purpose of refinancing student loans.

Maryland Economic Development Corporation

MEDCO is an entity established by the General Assembly to assist business and governmental entities through ownership, financing, and development of real and personal property projects.

MEDCO purchases or develops property that is leased to others under negotiated terms. MEDCO also makes direct loans to companies throughout the State to maintain or develop facilities, and it often serves as the conduit for loans administered by the Department of Commerce. MEDCO issues bonds to raise funds for its loans. The bond debt consists primarily of revenue bonds and notes. The debt represents nonrecourse obligations because MEDCO is not liable to bondholders and lenders in the event of a project or borrower default. Each project must have self-supporting revenues, and no projects are cross-collateralized. As a result, MEDCO debt is not debt of the State, and there is no implied State guaranty or State obligation to protect bondholders from losses.

MEDCO currently owns and operates 14 facilities, meaning that MEDCO is involved in management decisions and has a hand in ensuring successful daily operations. For most other projects, MEDCO generally serves as an arms-length financing entity. Recently MEDCO also has begun to be involved in a third type of project – where MEDCO owns a property and collects rent or other fees but is not involved in the management of the facility.

MEDCO is governed by a 12-member board of directors, including the secretaries of Commerce and Transportation as *ex-officio* voting members. MEDCO has nine full-time employees and one part-time employee, including an executive director, accountants, bond specialists, and administrative support staff.

MEDCO's exposure is mostly in private, limited offerings with infrequent access to the public market. MEDCO advises that its statute generally limits the corporation to financing real or personal property, which does not include student loans. MEDCO's statute would need to be altered to expressly include student loans as an eligible use of funds.

Maryland Department of Housing and Community Development – Community Development Authority

CDA issues nontax-supported debt with the goal of increasing the supply of affordable housing in the State. CDA funding is often used in tandem with other funds from the Department of Housing and Community Development budget to achieve the goals of various department programs. CDA generates its funding via the sale of tax-exempt revenue bonds, taxable bonds, and mortgage-backed securities. The projects proposed for CDA assistance must match local priorities and complement and supplement local community development programs. Tax-exempt bonds for private activity use are subject to a federal per capita cap, otherwise known as a volume cap, with unused capacity carrying forward into subsequent years.

In fiscal 2016, CDA issued $782.7 million in bonds across its single-family, multifamily, and local government infrastructure financing programs.

The scope of CDA's lending authority was recently expanded during the 2016 session. Chapter 146 of 2016 authorizes CDA to provide loans to qualified homebuyers and make payments on the homeowner's student loan debt. In practice, CDA has used this expanded authority to establish the Maryland SmartBuy Program. The program provides a five-year forgivable loan of up to 15% of the home purchase price for an eligible borrower to pay off outstanding student debt. The entire student debt must be paid off at the time of the home purchase; no remaining student loan debt after the loan closing is allowed.

While CDA does have the authority to issue bonds, its statutory purposes, staff expertise, and relationships with other professional services are focused on housing, and not higher education. CDA states that it does not currently have the statutory authority to issue bonds for a student loan refinancing program. In order to do so, its statute would need to be changed to explicitly authorize the issuance of bonds for the purpose of student loan refinancing.

Maryland Industrial Development Financing Authority

MIDFA is a State instrumentality housed in the Department of Commerce that promotes significant economic development by providing financing support to manufacturing, industrial, and technology businesses located in or moving to Maryland. MIDFA is governed by a nine-member board, including the Secretary of Commerce, and either the State Treasurer or Comptroller of Maryland, as the Governor designates, who serves as an *ex-officio* voting member. MIDFA appoints an executive director who serves as MIDFA's secretary and staff from the Department of Commerce administer MIDFA's programs and projects.

MIDFA issues both taxable and tax-exempt private activity revenue bonds to facilitate access to capital and provides credit insurance in the form of a loan guaranty to reduce lenders' risk. All projects must be in a Priority Funding Area. In addition to the issuance of private activity revenue bonds, MIDFA provides credit insurance through two programs which insure a portion of the debt service on bonds and loans made by financial institutions. The operating expenses of MIDFA are funded through the interest earned on the Industrial Development Fund balance, bond issuance fees, and annual premiums of 0.5% of all insured transactions, unless waived in certain counties.

As is the case with MEDCO, although MIDFA has the authority to issue bonds, MIDFA has expertise in the commercial lending market, which is different than the market in which bonds are sold to refinance student loans. MIDFA's statute would need to be amended to explicitly authorize MIDFA to issue bonds for the purpose of refinancing student loans.

Public Institutions of Higher Education

The University System of Maryland, Morgan State University, St. Mary's College of Maryland, and Baltimore City Community College have statutory authority to issue revenue bonds to finance the acquisition, construction, renovation, or operation of academic and auxiliary facilities. The proceeds from such debt financing can be used for classrooms, laboratories, residence halls, dining centers, athletic facilities, parking garages, or other facilities. The General Assembly must expressly authorize each academic project and the maximum principal amount of bonds for the project. Legislative authorization is not required for the issuance of auxiliary facility bonds; however, the General Assembly does establish a limit on the total amount of debt from academic and auxiliary bonds that may be outstanding at any time.

These revenue bonds are secured by auxiliary fees (income, fees, rents, charges, and other revenues from the use of auxiliary facilities) and academic fees (tuition, student, and activity fees). Repayment of debt service is available from those sources as well as from the proceeds of bonds and investment earnings and reserves or other funds established for the bonds under the trust agreement. These revenue bonds do not constitute a pledge of the full faith and credit of the State and are not considered State debt.

Although the public institutions of higher education in Maryland have the authority to issue bonds, their authority is limited to the issuance of revenue bonds to finance academic and auxiliary facilities. Therefore, the statutory authority of the public institutions of higher education would need to be amended to explicitly authorize the institutions to issue bonds for the purpose of refinancing student loans.

Entities without Bonding Authority, But With Connections to Higher Education Policy

Maryland 529

Maryland 529, formerly known as the College Savings Plans of Maryland, is an independent agency with a mission to provide simple, convenient ways for Maryland families to save in advance for college and reduce future reliance on loans. Maryland 529 currently offers two college savings plans: the Maryland Prepaid College Trust and the Maryland College Investment Plan. The Trust allows participants to lock in a current price for future college tuition benefits through a contract for payment of tuition and mandatory fees for a specified number of semesters or years of college. The Investment Plan, which is managed by T. Rowe Price, offers a variety of different investment options that allow participants to invest funds in Plan accounts to be used at any eligible college or trade school. Both the Trust and the Investment Plan offer federal and State tax benefits and are known as 529 plans after the section in the Internal Revenue Code that permits states to establish and administer tax-deferred college savings plans.

An 11-member board administers the Trust and oversees the administration of the plans. For fiscal 2017, the agency had 27 employees who managed the day-to-day operations and served in various capacities, primarily providing customer service to participants.

Maryland 529 does not have the authority to issue bonds; therefore, the agency lacks experience in the bond market, which is one of the essential requirements of a successful student loan refinancing program. However, Maryland 529 has a great deal of experience in providing customer service to participants of college savings plans, which might make the agency ideal to serve as a partner to a State student loan refinancing authority.

Maryland Higher Education Commission

MHEC is the State’s higher education planning and coordinating body and oversees various aspects of the public and private higher education system. The commission is required to advise the Governor and the General Assembly on statewide higher education policy, to conduct statewide planning for higher education, and to coordinate the overall growth and development of postsecondary education in Maryland. The commission provides statewide oversight by establishing and updating the State Plan for Postsecondary Education, approving new academic programs, and approving public and private institutions to operate in the State. The commission also oversees academic matters, administers the programs of State support for the community colleges and private nonprofit institutions, and administers State student financial aid programs.

The commission is governed by 12 members who are appointed by the Governor with the advice and consent of the Senate, and the Secretary of Higher Education. For fiscal 2017, the commission had 64 employees who performed various functions such as coordinating academic affairs, conducting research and policy analysis, and administering financial aid programs.

As with Maryland 529, the commission lacks experience in the bond market because the commission is not authorized to issue bonds. However, the commission's higher education expertise might make it an ideal partner for a State student loan refinancing authority.

Chapter 7. The Role of Counties and Other Jurisdictions

No Counties or Other Local Jurisdictions Operate Student Loan Refinancing Programs

Based on research conducted by the Department of Legislative Services and by the Montgomery County Office of Legislative Oversight (OLO), there are no counties or other local jurisdictions in the United States that offer a student loan refinancing program. The definitive reasons why there are currently no locally administered student loan financing programs are unknown; however, one reason may be that most local governments do not have a population base large enough to support a program. Nationally, about 90% of counties have fewer than 200,000 residents. In Maryland, 16 out of 24 counties have fewer than 200,000 residents. However, the two most populated counties in Maryland – Montgomery (1.0 million) and Prince George's (900,000) – each have a similar number of residents to Rhode Island, which currently operates one of the nation's model student loan refinancing programs.

Although the State's two most populated counties have a population base that is similar to a state with a successful student loan refinancing program, population base is just one of the many factors that must be considered in establishing a county student loan refinancing program. Other key factors are the market demand in the county for a student loan refinancing program, the ability of the county to provide significant financial resources to start and maintain a program, and its interest in doing so. For example, although some members of the Montgomery County Council have expressed support for establishing a student loan refinancing authority in Montgomery County, the OLO report contains agency comments from the Montgomery County Chief Administrative Officer expressing concerns about establishing a student loan refinancing program in Montgomery County because "…such a program is not fiscally responsible and is not the highest and best use of our limited County financial resources." Montgomery County estimates that a $100 million refinancing program would require $20 million to $30 million in start-up costs, the majority of which would collateralize the loans.

Another potential reason why no counties or other local jurisdictions offer a student loan financing program is that a state program may exist that already serves the individuals in that local jurisdiction who are in the market to refinance their student loans. Due to the finite market for program participants, if a state program exists and is serving the majority of the individuals who are in the market to refinance their student loans, the market for a county program – even in a large county – could be insufficiently large to support the program.

In a Finite Market, State and Local Programs Will Compete for the Same Residents

If the State Establishes a Refinancing Program, Local Programs Should be Prohibited

While the full extent of the demand for student loan refinancing in Maryland is unknown, the market is finite and also currently is served by private lenders and other state refinancing programs. In this context, one or more local refinancing programs, in combination with a State program, may oversaturate the market and jeopardize the viability of both the State program and local programs. For example, if Montgomery County or Prince George's County were to establish a county program, serving only its residents, it could draw up to about one-sixth of the State's population away from a State program.

Consequently, if the State establishes a student loan refinancing program, counties and other jurisdictions should be prohibited from establishing competing programs. If counties and other jurisdictions still wish to offer support for student loan refinancing, then their role should be limited to providing financial literacy counseling and information regarding the State loan refinancing program and other refinancing options, assistance with loan applications, and similar assistance.

If the State Does Not Establish a Refinancing Program, then Local Programs May Be Appropriate

If the State elects to not establish a student loan refinancing program, then one or more local government programs may offer a valuable in-state government/nonprofit resource for student loan refinancing. While local refinancing programs may wish to focus solely on their residents, in the absence of a State program, it would be the most efficient use of limited resources if one local program served all State residents.

Appendix 1. Sample Survey

Student Loan Refinancing Program

<u>Massachusetts</u>

Name and title of individual providing information:

____

Date of interview: ________________________

PART I. General Description of Bond Issuer

What is the name of the bond issuer ("Issuer")?	
When was Issuer formed?	
What is the purpose of the Issuer (*i.e.,* does it issue bonds for other purposes or was it created solely to issue bonds to refinance student loans? If it operates more than one program, how many are there and what do they finance?	
When did the Issuer begin issuing bonds to refinance student loans?	
Describe composition of the governing body of the Issuer (*e.g.*, areas of expertise represented) and the manner of their appointment.	
Are the Issuer's employees State employees?	

How many employees does the Issuer have? What are the qualifications/backgrounds of the Issuer's staff (*e.g.*, accountants, investment bankers, commercial bankers, treasury management personnel?	
What are the Issuer's annual revenues and expenses? Are they broken out by program? If so, what is the annual budget for the Student Loan Refinancing Program (the "Program")?	
Does the Issuer receive State appropriations? If not, how were the start-up costs of the Program financed?	
How many bonds has the Issuer issued? How much is outstanding now?	

PART II. Description of Student Loan Refinancing Program

When was the *Program* (not the bond Issuer) established?	
Who may participate in the Program (*e.g.*, students only, or parents as well? Only loans for undergraduate school or also graduate school)?	

Must the borrower have a connection to the state (*e.g.*, current State residents? People who attended college in the State? Only those who went to State colleges)?	
What are the borrower eligibility requirements (*e.g.* Income? Credit score?)	
What types of loans can be refinanced (e.g., federal? private?)	
Is there a maximum loan amount?	
Who makes the underwriting decisions?	
Does the State provide any financial assistance to the Program (*e.g.*, reserve funds, moral obligation, etc.)?	
Are the bonds credit enhanced? If not, what are the credit ratings on the bonds?	
Are there fees paid by borrowers in addition to interest on the loans (*e.g.*, program costs, fees of trustees, servicers, etc.).	
What is the total amount of student loans refinanced (to date)?	

What is the total amount of bonds issued to finance the Program to date?	
What is the total amount of Program bonds currently outstanding?	

PART III. Lessons Learned and Best Practices

What would you say are the "lessons learned" since the inception of the Program? What in your view are some of the "best practices" for running a successful program?

PART IV. Resources

It would be helpful if you could send us:

(1) By-laws
(2) A recent official statement or other offering document
(3) Program marketing materials
(4) Your recent audited financial statements
(5) Any other information that you think may be useful in connection with Maryland's study of loan refinancing programs