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Interest Rate Protection Agreements

A Progress Report

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About the Minnesota Office of Higher Education

The Minnesota Office of Higher Education is a cabinet-level state agency providing students with financial aid programs and information to help them gain access to postsecondary education. The agency serves as the state's clearinghouse for data, research and analysis on postsecondary enrollment, financial aid, finance and trends.

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Interest Rate Protection Agreements: A Progress Report by the Office of Higher Education

The Minnesota Office of Higher Education obtained legal authority during the 2007 legislative session to enter into interest rate exchange or swap agreements, hedges, forward purchase or sale agreements, or other comparable interest rate protection agreements with a third party in connection with the issuance or proposed issuance of bonds, outstanding bonds or notes, or existing comparable interest rate protection agreements (Laws of Minnesota 2007, Chapter 144). This authority was limited to $20 million. The law also required a report to the higher education committees of the legislature on any activity by the office under this authority. The language of the act is included in the appendix.

The intent in seeking this language was to test the viability of these agreements to aid in the stabilization or reduction of interest rates for students who obtain loans through the SELF Loan program. The SELF Loan program has existed since 1983. As of June 30, 2008 there were approximately 214,000 loans outstanding valued at over $691 million. The financing needed to provide the loans was obtained through bonds issued by the Office of Higher Education.

As of the date of this report, the agency has not entered into any interest rate exchange or swap agreements or other related activity. The Office of Higher Education met with financial advisors and investment bankers in the summer of 2007. Given the financial conditions at that time and structure of the financing of the SELF program, a determination was made by the agency not to pursue any agreements under the authority. This decision was reviewed in 2008 and the determination was again made that financial conditions did not warrant any action.

The Office of Higher Education recommends retaining this authority should conditions change that make these agreements more financially viable.

Appendix

Language from Laws of Minnesota 2007, Chapter 144
Sec. 28. Minnesota Statutes 2006, section 136A.16, is amended by adding a subdivision to read:

Subd. 16. **Interest rate swaps and other agreements.** (a) The office may enter into interest rate exchange or swap agreements, hedges, forward purchase or sale agreements, or other comparable interest rate protection agreements with a third party in connection with the issuance or proposed issuance of bonds, outstanding bonds or notes, or existing comparable interest rate protection agreements.

(b) The agreements authorized by this subdivision include without limitation master agreements, options, or contracts to enter into those agreements in the future and related agreements, including, without limitation, agreements to provide credit enhancement, liquidity, or remarketing.

(c) The agreements authorized by this subdivision may be entered into on the basis of negotiation with a qualified third party or through a competitive proposal process on terms and conditions as and with covenants and provisions approved by the office and may include, without limitation:

(1) provisions establishing reserves;

(2) pledging assets or revenues of the office for current or other payments or termination payments;

(3) contracting with the other parties to the agreements to provide for the custody, collection, securement, investment, and payment of money of the office or money held in trust; or

(4) requiring the issuance of bonds or other agreements authorized by this section in the future.

(d) With respect to bonds or notes outstanding or proposed to be issued bearing interest at a variable rate, the office may agree to pay sums equal to interest at a fixed rate or at a different variable rate determined in accordance with a formula set out in the agreement on an amount not exceeding the outstanding principal amount of the bonds or notes at the time of payment in exchange for an agreement by the third party to pay sums equal to interest on a like amount at a variable rate determined according to a formula set out in the agreement.

(e) With respect to bonds or notes outstanding or proposed to be issued bearing interest at a fixed rate or rates, the office may agree to pay sums equal to interest at a variable rate determined in accordance with a formula set out in the agreement on an amount not exceeding the outstanding principal amount of the bonds or notes at the time of payment in exchange for an agreement by the third party to pay sums equal to interest on a like amount at a fixed rate or rates determined according to a formula set in the agreement.

(f) Subject to any applicable covenants of the office, payments required to be made by the office under the agreement, including termination payments, may be made from amounts pledged or available to pay debt service on the bonds or notes with respect to which the agreement was made or from assets of the loan capital fund of the office. The office may issue bonds or notes to provide for any payments, including, without limitation, a termination payment due or to become due under an agreement authorized under this section.

(g) The authority of the office to enter into interest rate protection agreements under this section is limited to agreements related to bonds and notes with an aggregate value of no more than $20,000,000.

Sec. 51. **INTEREST RATE PROTECTION AGREEMENTS; REPORT.**

The Office of Higher Education must report by February 1, 2009, to the senate and house of representatives committees with primary jurisdiction over higher education finance and policy on the results of the office's interest rate protection agreement activity under Minnesota Statutes, section 136A.16, subdivision 16.