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# Assessing the feasibility of creating a SELF Loan Refinancing Program

## Authors

Marilyn Kosir  
SELF Loan Manager  
Tel: 651-355-0600  
[Marilyn.Kosir@state.mn.us](mailto:Marilyn.Kosir@state.mn.us)

Danette Jerry  
Financial Services Manager  
Tel: 651-259-3951  
[Danette.Jerry@state.mn.us](mailto:Danette.Jerry@state.mn.us)

Peter Li  
Intern  
Tel: 651-259-3977  
[Peter.Li@state.mn.us](mailto:Peter.Li@state.mn.us)

Thomas Sanford, Ph.D.  
Finance & Accountability Manager  
Tel: 651-259-3960  
[thomas.sanford@state.mn.us](mailto:thomas.sanford@state.mn.us)

## 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 also serves as the state's clearinghouse for data, research and analysis on postsecondary enrollment, financial aid, finance and trends.

The Minnesota State Grant Program is the largest financial aid program administered by the Office of Higher Education, awarding up to \$180 million in need-based grants to Minnesota residents attending eligible colleges, universities and career schools in Minnesota. The agency oversees other state scholarship programs, tuition reciprocity programs, a student loan program, Minnesota's 529 College Savings Plan, licensing and early college awareness programs for youth.

The Office of Higher Education also administers the SELF Loan program, which provides long-term, low-interest loans to students who need financial assistance to pursue their postsecondary goals. Since the program's inception in 1984, the SELF program has provided over \$2 billion in educational financing to over 250,000 students.

## Minnesota Office of Higher Education

1450 Energy Park Drive, Suite 350  
Saint Paul, MN 55108-5227  
Tel: 651.642.0567 or 800.657.3866  
TTY Relay: 800.627.3529  
Fax: 651.642.0675  
E-mail: [info.ohe@state.mn.us](mailto:info.ohe@state.mn.us)  
[www.getreadyforcollege.org](http://www.getreadyforcollege.org)  
[www.ohe.state.mn.us](http://www.ohe.state.mn.us)

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# Introduction

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Since the Student Education Loan Fund (SELF) Loan program's inception in 1984, over 250,000 students have received more than \$2 billion in SELF Loans to pursue their postsecondary education (Minnesota Office of Higher Education, 2014a). The SELF Loan program provides undergraduate and graduate students with long-term, low-interest educational loans. Unlike most private lenders, SELF Loan interest rates are universal for all students regardless of credit score.<sup>1</sup> As the costs of higher education have increased for students and their families over the past three decades, SELF Loans have played an increasingly important role in providing students with the financial resources needed to pay for their education; however, the SELF program loan limits have failed to keep pace with the cost of college potentially forcing students to choose higher-priced alternatives.

Nationally, there appears to be growing demand for student loan refinancing programs, as evidenced by the number of state and private programs that have emerged in recent years. Inherently, a borrower's decision to refinance their student loans signals that their current loans are inadequately serving their needs or there are more favorable options. Borrowers refinance their student loans for several reasons including:

- to obtain a lower interest rate
- to increase or shorten the length of the loan repayment
- to consolidate multiple loans from multiple lenders
- to lower their monthly payment (by utilizing one or all of the above options)

While student loan refinancing programs can play an important role in improving the financial position of borrowers, it is in the student's best interest to obtain low cost financing while they are enrolled in school rather than waiting to refinance after graduating.<sup>2</sup>

This report presents a framework for establishing a SELF Loan Refinancing program and outlines strategic modifications to the existing SELF Loan program to better meet the needs of students and reduce their need to refinance. Specifically, the report presents an overview of other state's loan refinancing programs, outlines characteristics of a proposed Minnesota pilot refinancing program, and discusses challenges to implementing a SELF Loan Refinancing program. Additionally, it provides a summary of the current SELF Loan program and outlines strategies to strengthen the program to more effectively meet student needs.

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<sup>1</sup> The SELF loan program does not consider the credit score of the borrower or the co-signer when determining a borrower's interest rate.

<sup>2</sup> Students that obtain loans with higher interest rates and wait to refinance until after graduating will be faced with additional interest costs.

# SELF Loan Refinancing Program

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## ***Context***

In 2014, legislation was passed authorizing the Minnesota Office of Higher Education (OHE) to begin a student loan refinancing program (Minnesota 136A.1704). The legislation is emblematic of the growing national interest to provide graduates with financial relief through lower interest rates and diverse repayment terms. To explore the feasibility of beginning a refinancing program, OHE has consulted with financial advisors, conducted a survey of state refinancing programs, and attempted to identify public and private products to determine if a state-affiliated program could successfully compete in the marketplace. As a result, OHE tentatively plans on offering a Minnesota student loan refinancing program on a pilot basis without a state subsidy. In the sections that follow, the results of other state student loan refinancing programs are presented, a proposed framework for a Minnesota refinancing program is delineated, and finally, challenges and opportunities to beginning and sustaining a successful program are discussed.

## ***State Refinancing Program Survey***

To understand the viability of beginning a student loan refinancing program, the Office of Higher Education surveyed 16 states that are part of a national coalition of State Student Education Loan Programs. Key questions the survey addressed were:

- Does the state currently, or previously, offer a student loan refinancing program?
- What was the impetus behind the decision to offer a refinancing program?
- How did state program officials determine market demand?
- Did the program begin as a pilot program? If so, what was the loan volume in the first year?
- What are the program eligibility requirements, and what are the program characteristics?
- How much flexibility does the state loan refinancing program have to make changes to the program in a timely manner to adjust to market conditions?

Of the 16 states, 10 responded to the survey, a 63 percent response rate. Additionally, interviews were conducted with staff from responding states and data was collected from program websites to supplement the survey results. Table 1 presents an overview of the states' refinancing programs. Of the 10 respondents, only three currently have a refinancing program; two of which are pilot programs that began in 2014 (Rhode Island and Iowa). Only one program, North Dakota's, is currently active and fully implemented. Three states (Massachusetts, Vermont, and Alaska) are currently considering beginning a refinancing program, with Massachusetts' program anticipated to begin in 2015.

States listed two primary reasons for creating student loan refinancing programs, declining portfolio balances associated with their in-school loan programs and market demand. Accurately estimating market demand is extremely challenging due to the lack of publicly available data. All of the states that had initiated a refinancing program, or were thinking about doing so, noted they were unable to estimate the potential market demand. Despite these limitations, the high percentage of state respondents implementing, or considering implementing, refinancing programs suggests that respondents believed that there was sufficient demand to establish a refinancing program; however,

two of the five respondents' refinancing programs are not currently active. Both states that suspended their loan refinancing programs generated less than \$6 million in loan volume in their first year. Additionally, two of the three active programs (Iowa and Rhode Island) are limited to pilot programs and anticipate loan volumes of \$4 million and \$10 million, respectively. Only North Dakota's refinancing program generated loan volumes in excess of \$10 million in their initial year.

**Table 1:** Overview of State Refinancing Programs

	State	Year Began or Anticipated	Impetus	Began as a pilot program	Loan volume (or anticipated loan volume) in the first year
<b>States that Currently have a refinancing Program</b>	Rhode Island	2014	Declining portfolio balances & Market demand	Yes	Anticipated \$10M
	Iowa	2014	To test market demand	Yes	Pilot is limited to \$4M
	North Dakota	2007 enhanced in 2014	Market demand	No	Exceeded \$10M
<b>Loan refinancing program is not currently active</b>	Maine	2006	Market demand	No	Approximately \$2M
	South Carolina	2009 2015 (New Program) <sup>3</sup>	Declining portfolio balances & Market demand	No	Approximately \$6M
<b>Do not have a refinancing program, but are considering beginning one</b>	Massachusetts	2015	Market demand		
	Vermont		Market demand		Anticipating \$10M
	Alaska		Declining portfolio balances & Market demand		

Table 2 presents characteristics of states' loan refinancing programs. Of the five programs currently or formerly active, two states (North Dakota and Maine) allowed both state residents and non-residents to participate in the program. States primarily offer fixed rate loan products, and typically offer 10 and 15 year repayment terms. All of the state programs have maximum borrower limits of at least

<sup>3</sup> South Carolina will implement a new refinancing program in 2015. The new program will expand eligibility to parents with Parent Plus loans, a key difference from their previous program.

**Table 2:** State Loan Refinancing Program Characteristics

	State	Who is Eligible? (Residents or Non-Residents)	Loan Types Offered (Fixed or Variable)	Repayment Terms Available	Interest Rate <sup>4</sup>	Borrower Maximum Loan Amount	Program Modifications (e.g., changes to program term, limits, interest rates, etc.) Require Legislative/Statutory Changes
<b>States that currently have a refinancing program</b>	Rhode Island	Residents only	Fixed	5, 10, and 15 year	4.99% for 5 year term 5.99% for 10 year term 6.99% for 15 year term <sup>5</sup>	\$140,000	No approval is required
	Iowa	Residents only	Fixed	10 and 15 year	The weighted average interest rate of the loans being consolidated, rounded up to the nearest one-eighth of a 1%	\$150,000	No approval is required
	North Dakota	Residents & Non-residents	Fixed & Variable	10, 15, 20, and 25 year	Resident rates: Variable (1.74% APR), Fixed (4.83% APR). <sup>6</sup> Non-resident rates: Variable (3.54% APR), Fixed (6.67% APR)	No limit <sup>7</sup>	No approval is required
<b>Loan refinancing program is not currently active</b>	Maine	Residents & Non-residents	Variable	15, 20, and 25 year	8.75%	\$125,000	Rules on Program Eligibility Requirements, Loan Limits, and Repayment Terms
	South Carolina	Residents only	Fixed Fixed	10 and 15 year	6.75% <sup>8</sup> 5.99%	\$100,000 \$150,000	No approval is required

<sup>4</sup> As of January 12, 2015

<sup>5</sup> Rates are reduced by 1 percentage point with the addition of a co-signer.

<sup>6</sup> The variable rate is capped at 10% and cannot exceed a 1% increase in any given year. The rates for residents and non-residents are the same regardless of term.

<sup>7</sup> If borrowers meet debt to income ratio requirement

<sup>8</sup> A quarter percent reduction is available if borrowers agree to automatic withdrawal

\$100,000. Perhaps most importantly, all but one of the programs was able to modify their program characteristics (e.g., loan repayment terms, loan limits, interest rates, and underwriting requirements – such as FICO scores and debt-to-income ratios) without seeking changes through rules or legislation. Only Maine required changes to rules to modify program characteristics and the program is no longer active.

The survey results raise key issues that should be carefully evaluated before implementing a program. Despite the perception of robust market demand to support a state-based refinancing program, two of the five state-based refinancing programs are not currently active and two are in their first year as pilot programs. The inability to accurately estimate demand coupled with two state programs that are not currently active, emphasizes the need for Minnesota’s student loan refinancing program to have significant flexibility to adjust to market trends.

**Market Competition**

In addition to the current and emerging state loan refinancing programs that allow non-resident participation, there are numerous private lenders in the marketplace competing for market share. Table 3 presents the current pricing structure of several private lenders for both fixed and variable interest rate refinancing loan products. In addition to the private lenders listed, there are also several credit unions, which are not presented, that are active in the marketplace that could impact demand for the proposed program.

**Table 3:** Private Lender Fixed and Variable Interest Rates\*

Private Lender	Fixed Interest Rates	Variable Rates
Citizens Bank & Charter One Bank	4.74% - 10.26% APR	2.32% - 8.43% APR
SoFi (Social Finance)	3.50% - 7.24% APR	2.17% - 5.17% APR <sup>9</sup>
Wells Fargo	7.24% - 12.29% APR	3.75% - 8.75% APR
iHELP Loans	6.22% - 9.04% APR	---
Common Bond	3.89% - 7.49% APR	2.66% - 5.91% APR

\* As of January 15, 2015

Private lenders typically utilize risk-based pricing, which allows them to offer lower rates to their most preferable customers, measured by their credit risk and ability to pay. These lenders advertise “teaser” rates to all potential customers knowing that only a small fraction of applicants will qualify for the lowest rates based on their underwriting criteria. Customers that do not qualify for these “teaser” rates may be offered higher pricing, which may not be competitive. It is unclear whether a significant proportion of customers that do not qualify for the “teaser” rate shop around to obtain competitive pricing or if they just accept the higher rate they were offered. Having a larger share of “preferable”

<sup>9</sup> Not available in Minnesota



customers allows lenders to offer lower priced loans across their portfolio because of the portfolio's lower default risk, and as a result the lower collateral that a loan refinancing program is required to pledge against the portfolio to secure financing. In order to be sustainable, Minnesota's loan refinancing program's portfolio will need to include a significant proportion of these preferable customers in order to offer competitive interest rates.

### ***Overview of the Proposed Minnesota Refinancing Program***

The Office of Higher Education tentatively plans to offer long-term, low-interest educational student refinancing loans on a pilot basis. The pilot refinancing program is intended to provide interest rate reductions and/or repayment term changes for qualifying borrowers. Presented below is the framework developed in consultation with the SELF Program's financial advisors for Minnesota's proposed pilot loan refinancing program. Following the proposal, a discussion of challenges to implementing the program and factors affecting if and when the program may be operational is presented.

#### **Program Eligibility:**

- Open to Minnesota residents.
- Open to SELF Loan customers living out of state that refinance a SELF Loan.
- Participants will be required to have earned a postsecondary degree, certificate, or diploma.
- There will be a minimum FICO score required for borrower/cosigner.
- There will be a maximum debt-to-income ratio for borrower/cosigner to ensure the borrower/cosigner has the ability to repay the loan.

#### **Program Characteristics:**

- The pilot refinancing program would offer both fixed- and variable-rate loans.
- The program will require a minimum loan amount, which is tentatively planned to be \$10,000.
- Minnesota 136A.1704 established a maximum refinancing loan limit of \$70,000 for borrowers.<sup>10</sup> Borrowers with an Associate's degree or a postsecondary certificate or diploma are expected to have lower loan limits.
- Participants will be allowed to consolidate federal student loans, including the federal Graduate PLUS loans.
- Delinquent and defaulted student loans will not be eligible for consolidation.
- Co-signers will not be required if the borrower meets the program's credit criteria.
- The program will have a co-signer release option after the borrower has made a predetermined number of on-time payments, and if the borrower meets the program's credit and income requirements at the time the co-signer is eligible for release.
- Loans will be forgiven in case of death of the borrower.

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<sup>10</sup> The loan limits specified in law are currently lower than all state-affiliated refinancing programs surveyed.

### **Program Pricing Considerations:**

- The program will not charge any origination fees.
- Loans will be offered with repayment terms of 5, 10, or 15 years.
- Interest rates will be determined based on current market conditions and the length of the repayment term.<sup>11</sup> It is the intent of the program to provide a universal interest rate within each loan product type (fixed vs. variable) and repayment term (5, 10, 15 years) regardless of the eligible borrower's or cosigner's credit score.<sup>12</sup>

### **Challenges to Implementation**

A significant barrier to starting the refinancing program is the Minnesota Statutes Chapter 16C contracting requirements. A specific example of the problem relates to the E-Verify requirement. For contracts over \$50,000 the contractor is required to collect certifications from all sub-contractors verifying they are in compliance with, or they are in the process of implementing the federal E-Verify program. The credit bureau currently used by the SELF program believes they cannot certify that all sub-contractors they purchase data from are in compliance with E-Verify, and as a result are not willing to sign a state contract with that requirement. Because the SELF Loan Refinancing program will require credit reports for all borrowers and cosigners, the 16C contracting requirements may be prohibitive to the establishment of a SELF refinancing program. OHE anticipates that the additional volume of credit reports needed for the refinancing program and the purchase of potential customer lists would require a contract larger than \$50,000. A statutory exemption for processing, servicing, and collecting on student loans from the 16C contracting requirements is needed to overcome this barrier.

An equally important consideration to ensuring the sustainability and success of a loan refinancing program is administrative flexibility allowing timely modification of program criteria, characteristics, loan limits, terms, and pricing in response to market conditions. Given that two of five state loan refinancing programs surveyed are currently not active and two others are only in their pilot year and are anticipating low loan volume, it is critically important that the changes to the program can occur on an expedited timeline. Any changes made to the refinancing program's criteria, characteristics, loan limits, terms, and pricing would only affect new loan disbursements, not outstanding refinancing loans.

### **Important Considerations**

The program must be self-sustaining from borrower payments because the refinancing program will not receive a state subsidy. Additionally, the intent is not to subsidize the refinancing program with the existing SELF program. Subsidizing the refinancing program with the existing SELF program would result in higher interest rates, and therefore higher costs, for students participating in the existing SELF Loan program. Additionally, while the existing SELF program is able to fund loans utilizing tax-exempt revenue bond financing, which generally has lower interest rates than taxable revenue bonds, current

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<sup>11</sup> Some borrowers may choose to take out a refinancing loan with a higher interest rate in order to extend repayment length or change from a variable to a fixed rate.

<sup>12</sup> In other words, all borrowers that select a 5-year fixed rate loan would have the same interest rate; however, the interest rate for a 5-year variable or a 10-year fixed rate loan would both be different from a 5-year fixed rate loan and from each other.

federal tax laws do not allow the refinancing program to utilize tax-exempt funding. As a result, the cost of funding the refinancing program will be higher than the existing SELF Loan program, which will result in higher interest rates for borrowers than if they had initially utilized SELF Loans.

### **Program Implementation Timeline**

The timeline for an operational program is dependent upon the time needed to select a servicer and develop the servicing system, issuing taxable revenue bonds to provide financing for the program if needed, and resolve 16C contracting issues. Given these variables, the program is anticipated to be operational by the spring of 2016; however, the intent is to begin the program's operation as soon as possible.

### ***Summary – Pilot Minnesota Refinancing Program***

Student loan refinancing programs provide a solution for borrowers whose current loans are inadequately serving their needs or there are more favorable options. Borrowers refinance their student loans for several reasons, including: to obtain a lower interest rate, to increase or shorten the length of the loan repayment, to lower their monthly payments, or to combine several loans in order to have a single bill. To this end, the Office of Higher Education tentatively plans to offer long-term, low-interest student refinancing loans on a pilot basis.

Ultimately, the refinancing program's success will depend on the competitiveness of the program's terms and administrative flexibility allowing prompt alteration of the program's eligibility criteria, loan limits, repayment terms, and pricing criteria in response to changing market conditions. Additionally, in order to implement and operate the program, the SELF Loan Refinancing program may need a statutory exemption to the Chapter 16C contracting requirements. Dependent upon the time needed to select a servicer and develop the servicing system, issuing taxable revenue bonds to provide financing for the program if needed, and resolve 16C contracting issues, the program is anticipated to be operational by the spring of 2016.

While student loan refinancing programs can play an important role in improving the financial position of graduates, it is in the student's best interest to obtain low cost financing while they are enrolled in school at the time of initial disbursement rather than waiting to refinance after graduation. In addition to beginning a refinancing program, there are strategic opportunities that the legislature can leverage to ensure that the existing SELF Loan program better meets the needs of students and reduce the likelihood that they will need to refinance their student loans in the future. The remainder of this report discusses two changes that would help the current SELF program mitigate students' need to refinance their student loans after graduation.

# SELF Loan Program

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## Context

In the early 1980s higher education leaders recognized that Minnesota's state investment in higher education would not be able to keep pace with the rising costs of higher education, and that students and their families would become responsible for a larger share of the costs (Longanecker, 2014, September 30). As a result, in 1983, the Legislature adopted the *Design for Shared Responsibility*, a nationally recognized framework for allocating the state's need-based grant funds. The framework specifies each stakeholder's responsibility (the student, their family and state and federal taxpayers) in funding postsecondary education and was guided by four broad tenets:

- Recognize the full cost of attendance (COA).
- Allow students to select the postsecondary institution that best meets their needs, while recognizing the cost of choice.
- Explicitly identify the partners and their roles, and
- A commitment to preserve financial access for all Minnesotans.

As the principal beneficiary, the student holds the first responsibility in financing the cost of their education (50% of the cost).<sup>13</sup> Students could pay for their assigned share by utilizing personal savings or through current earnings (income from working) or future earnings (student loans). The model then requires parents to contribute depending on their ability to pay. Next the framework captures all the grant aid available from the federal government, and finally, the state assists in filling the gap.

In order to ensure that all students had access to financial aid resources to meet the full cost of attendance, the Legislature also created the Student Educational Loan Fund (SELF) program in 1984 (Minnesota Higher Education Coordinating Board, 1987). Over time, as the proportion of institutional revenue covered by students (and their families) has increased from 24 percent in fiscal year 1988 to 47 percent in fiscal year 2013, the SELF program played an increasingly important role in assisting students in funding their educational costs (SHEEO, 2014).<sup>14</sup>

Between 1995 and 2014, the SELF Loan program has provided almost \$1.8 billion in financial aid to students through over 420,000 loans (Figure 1).<sup>15</sup> The figure also shows a steep decline in participation in the SELF Loan program beginning in 2005. From 2008 to 2014, the number of new loans issued by the SELF program declined from 28,302 to 9,416, a decline of over 66 percent. There are likely two primary factors that contributed to this decline: the inability of the SELF program's loan limits to keep pace with the rising costs of higher education and a 2008 federal law regarding preferred lenders.<sup>16</sup>

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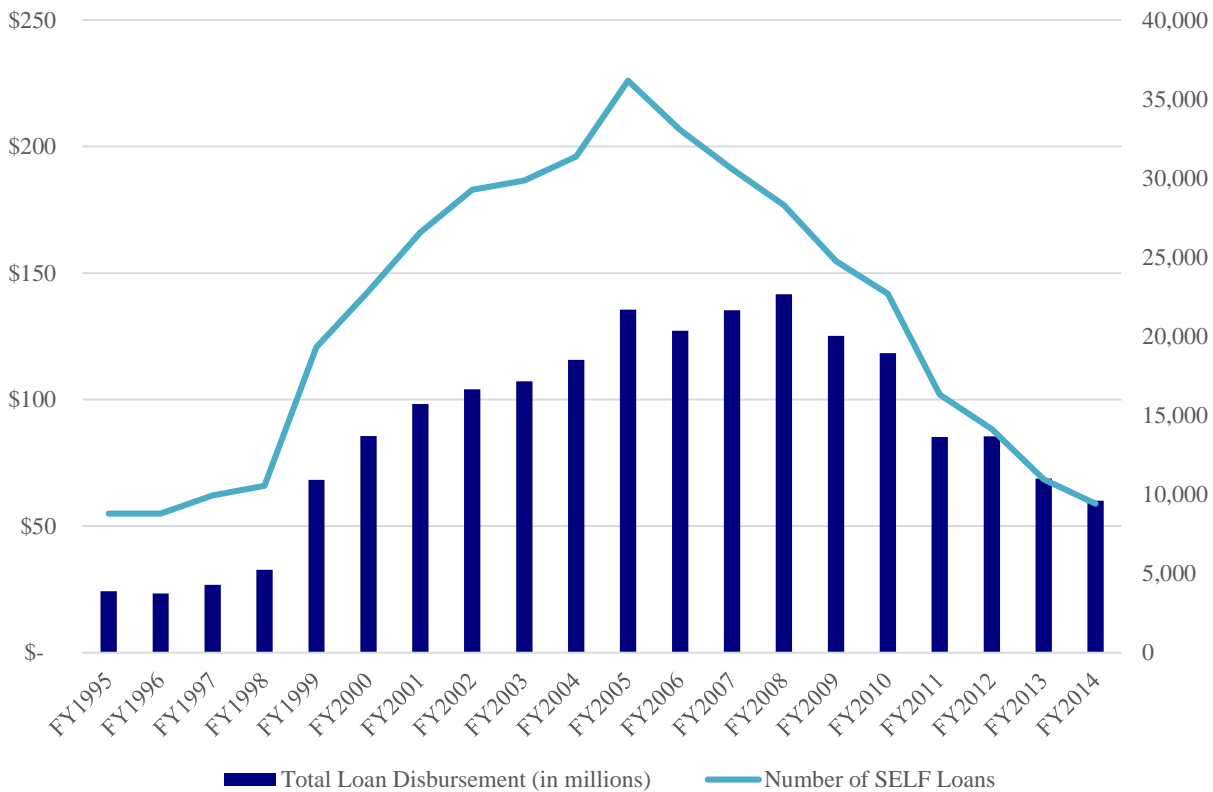
<sup>13</sup> Over time the student's responsibility share has varied, dropping to 46 percent for most of the 1990s. In fiscal year 2014, the student's share was restored back to 50 percent.

<sup>14</sup> The estimates from SHEEO are based on national data.

<sup>15</sup> Since the SELF Loan program's inception in 1984, the program has provided over \$2 billion in financial aid.

<sup>16</sup> In addition, in 2008-09 the amount a student could borrow per year in federal unsubsidized loans increased by \$2,000, which affected student behavior.

**Figure 1:** Number of SELF Loan Disbursements and Disbursement Amounts, Fiscal Years 1995 – 2014.



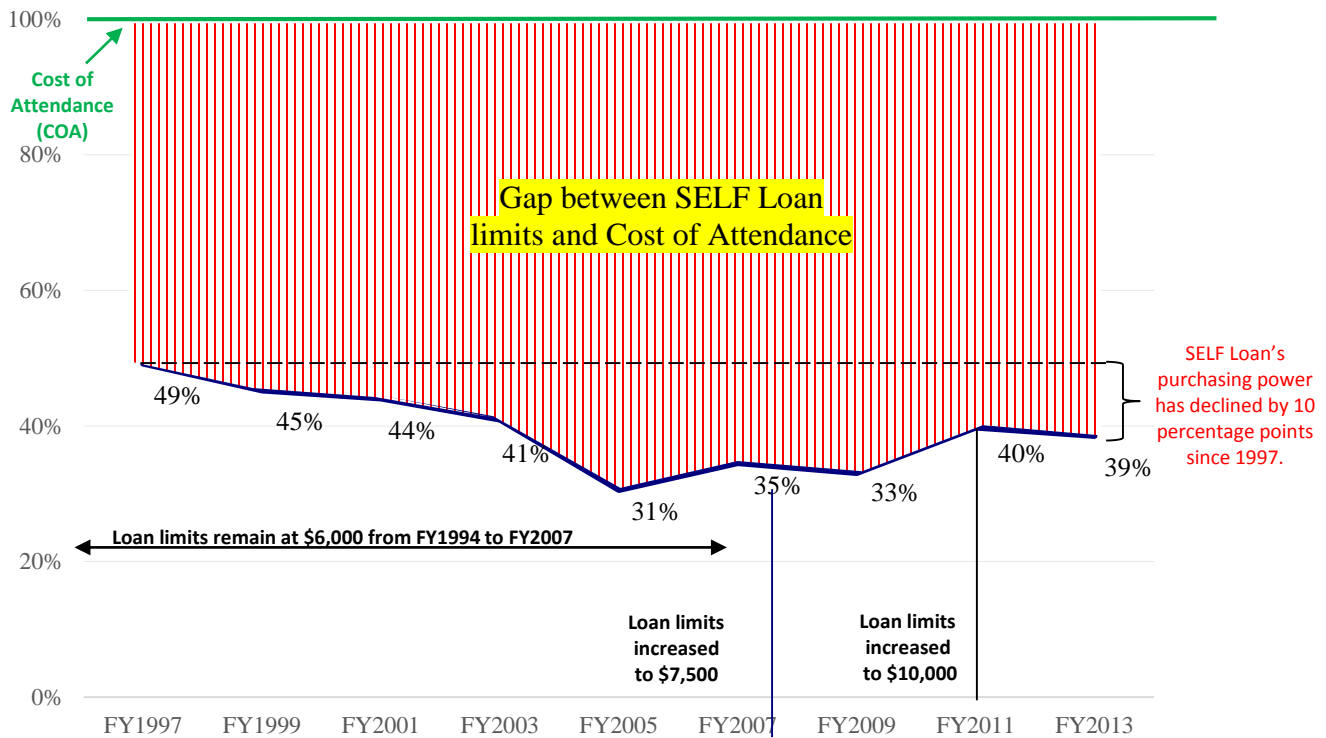
**State Loan Limits**

SELF Loans play a vital role in helping students finance their postsecondary education. Over the past two decades, however, the proportion of the cost of attendance that a SELF Loan covered has declined due to increases in postsecondary costs and the SELF program’s loan limits inability to increase at equivalent levels. The SELF Loan program was created by the Legislature to provide financial aid access to students through loans for up to the cost of attendance.<sup>17</sup> Figure 2 shows the SELF program’s loan limits in relation to a student’s Cost of Attendance (COA) at the University of Minnesota, Twin Cities campus from fiscal years (FY) 1997 to 2013. From FY1994 (not shown) to FY2007, the SELF Loan program’s loan limits remained stagnate at \$6,000 while the costs of higher education continued to rise, which resulted in an erosion of the SELF Loan program’s purchasing power.<sup>18</sup>

<sup>17</sup> Most state-affiliated in-school student loan programs cover the cost of attendance to pursue a postsecondary education.

<sup>18</sup> From fiscal years 1994 to 2007 the loan limits differed by the number of years the student had been enrolled. Undergraduate students that were in their first two years were unable to borrow more than \$4,500 per year, while third year students and above were limited to \$6,000. Beginning in fiscal year 2008, the loan limits were \$7,500 for all undergraduate students, regardless of the number of years they were enrolled.

**Figure 2:** SELF Loan Limits as a Percentage of a Student's Cost of Attendance at the University of Minnesota - Twin Cities Campus, Fiscal Years 1997 - 2013.



To address this erosion, the Legislature approved increases in the SELF program’s loan limits in FY2007 and FY2011. In FY2007 the loan limits were increased from \$6,000 to \$7,500, which increased the percentage of the COA covered by the SELF program from a low of 31 percent in FY2005 to 35 percent in FY2007. Over the next biennium, however, with no additional increases in the loan limits, the percentage of the COA covered by the SELF program once again declined to 33 percent. A similar story emerges prior to, and after, the Legislative increase in the loan limits to \$10,000 in FY2011. Only once during the period, in FY1997, did the SELF Loan program’s loan limits exceed the student’s share.

The SELF Loan limits’ inability to maintain its purchasing power impacts students’ ability to finance their education and forces them to find alternative funding sources usually at a higher cost to the borrower. For example, if the student is dependent on student loans to finance the costs of their education, they may be forced to take out loans from multiple providers in order to meet their financial needs. Having loans with multiple providers and higher interest rates likely increases the probability that students will attempt to consolidate their loans in the future.

Additionally, students may end up taking out higher interest rate loans, increasing their costs, compared to the low-interest loans offered by the SELF program (Table 4).<sup>19</sup> Anecdotally, several institutions have stated that students are increasingly choosing alternative lenders instead of SELF Loans because the SELF program's loan limits are inadequate. If they chose to utilize SELF loans to finance their education, they would still be required to obtain loans from additional lenders to meet their needs, which is not their preferred option when other providers are able to meet all of their financing needs in a single loan.

**Table 4:** Average interest accrued in school for SELF Loans compared to average Private lenders' loan products and the Federal Parent Plus loan.

Interest while in School						
<i>Variable Rate Loan Comparison</i>						
	Interest Rate	Year 1	Year 2	Year 3	Year 4	Total
<b>SELF Loan</b>	3.20%	\$320	\$640	\$960	\$1,280	<b>\$3,200</b>
<b>Other Private Loan</b>	6.27%	\$627	\$1,254	\$1,881	\$2,508	<b>\$6,270</b>
<i>Fixed Rate Loan Comparison</i>						
<b>SELF Loan</b>	6.90%	\$690	\$1,380	\$2,070	\$2,760	<b>\$6,900</b>
<b>Federal Parent Plus Loan</b>	7.21%	\$721	\$1,442	\$2,163	\$2,884	<b>\$7,210</b>
<b>Other Private Loan</b>	9.04%	\$904	\$1,808	\$2,712	\$3,616	<b>\$9,040</b>

Notes:

1. Assumes a student borrows \$10,000 per year for four years.
2. Interest is calculated based on one disbursement per academic year.
3. Each year represents a calendar year of interest.
4. "Other Private Loan's" average interest rate was calculated by averaging the low and the high rate offered for a sample of private lenders and then averaging across lenders.
5. The SELF Loan program requires students to make interest payments while they are enrolled. If private lenders do not have the same requirement, their total interest will be higher due to the compounding of interest.

### ***Federal Preferred Lender Law Change***

As part of the reauthorization of the Higher Education Act in 2008, the federal government no longer allowed postsecondary institutions to provide information to students regarding non-federal student loans unless they adhered to requirements for establishing a preferred lender list. State-affiliated loan programs, such as the SELF Loan program, could no longer be included in a student's Financial Aid Award Notice unless the student had previously borrowed a SELF Loan. Instead, the SELF Loan is now included on a list of numerous private lenders that offer higher cost student loans (Ibrahim, 2010, August 4).

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<sup>19</sup> Students typically exhaust their federal student loans before utilizing SELF loans, loans from private lenders, or the Federal Parent Plus loans.

Figure 3 shows the amount of new loan disbursements and the program’s total portfolio balance from fiscal years 1999 to 2014. The red line indicates the Higher Education Act reauthorization and the preferred lender changes. In the immediate fiscal year following the reauthorization, the number of students at the University of Minnesota, Twin Cities campus who took out a SELF Loan dropped from 10,641 to 7,823, or 26 percent (Ibrahim, 2010, August 4). Due to confusion at the institutions about the state-affiliated program being considered a private loan the policy change was implemented at different times by institutions in the immediate years following the reauthorization. Institutions could include the SELF Loan on the Financial Aid Award Notice to previous borrowers so the true impact of the federal change was not evident until FY2011 and later. Between FY2008 and FY2011, the number of new SELF Loans disbursed dropped by almost 40 percent. The program’s new loan disbursements have continued to decline, and the effect on the program’s portfolio can be seen beginning in FY2010.

**Figure 3: SELF Loan New Disbursements and Total Portfolio Balance, Fiscal Years 1999-2014**



**Opportunities to Strengthen the Program to Meet Students’ Needs**

While student loan refinancing programs can play an important role in improving the financial position of borrowers, students would benefit from obtaining the lowest cost financing at the time of disbursement (while they are enrolled) rather than refinancing after graduation.<sup>20</sup> The SELF program has been proactive in meeting students’ needs by developing loan terms and pricing that addresses

<sup>20</sup> Students that obtain loans with higher interest rates and wait to refinance until after graduating will be faced with additional interest costs.



many of the problems that a loan refinancing program is developed to solve. For example, SELF borrowers receive only one bill from the program even if they have multiple SELF Loans. The program also addresses students' cash flow concerns by offering repayment terms of up to 20 years depending on students' cumulative SELF Loan balance. Finally, as a state-affiliated student loan program, the program also offers low-interest loans to all eligible students regardless of credit score.

Increasing the SELF Loan limits would minimize students' need to take out additional and potentially higher interest rate private loans while they are enrolled. Currently, the program's loan limits can only be increased through legislative action, which can resolve the issue in the short-term; however, the changes occur after SELF Loans have lost a significant portion of their purchasing power, affecting students' ability to participate in the program. A long-term permanent solution would be to tie the SELF Loan limits to the cost of attendance, less other financial aid.

At the federal level, changes to the federal preferred lender law to allow institutions to provide information to students either on the award letter, through materials in their office, or in response to questions from students and families about the SELF Loan would be beneficial. Under the current law institutions can only provide information and respond to questions if they have gone through the process of creating a preferred lender list. Even utilizing preferred lender lists, institutions cannot include the SELF Loan on an award letter unless the student previously borrowed the SELF Loan. A detailed outline of suggested changes to the law is presented in Appendix A. Providing students with greater access to the SELF Loan program would mitigate the number of students from taking out higher interest rate loans, compared to the low-interest loans offered by the SELF program.

### ***Summary – Current SELF Loan Program***

The SELF Loan program was created by the Legislature to ensure that all students had access to financial aid resources to fund the full cost of attendance of pursuing a postsecondary education. Over time, however, the proportion of the cost of attendance that a SELF Loan covered has declined due to increases in postsecondary prices and the SELF program's loan limits' inability to increase at equivalent levels in a timely fashion. Tying the SELF Loan limits to the cost of attendance, as was originally intended, less other financial aid and with limits determined annually by the Office of Higher Education, would ensure that the program's loan limits adjust to better meet the financial needs of students pursuing a postsecondary education. Additionally, pursuing changes to the federal preferred lending law that would allow state-affiliated student loan programs, such as SELF Loans, to appear on students' award letters would provide students with greater access to the SELF program and mitigate the number of students taking out higher interest rate loans.

## Conclusion

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Student loan refinancing programs are emerging because borrowers who have graduated were unable to obtain the lowest cost funding while in school, lack a repayment term that meets their needs, were unable to borrow adequate funding to finance their education from a single provider, or because market conditions have improved and lower cost financing is available. To this end, at Legislative direction, the Office of Higher Education tentatively plans to offer long-term, low-interest educational student refinancing loans on a pilot basis. Ultimately, the refinancing program's success will depend on the competitiveness of the program's terms and the program's administrative flexibility to alter the program's eligibility criteria, loan limits, repayment terms, and pricing criteria in response to changing market conditions. In order to implement and operate the program, the SELF Loan Refinancing program may need a statutory exemption to the Chapter 16C contracting requirements. While no timeline has been established for when the program could be operational, the intent is to begin the program's operation as soon as feasibly possible.

While student loan refinancing programs can play an important role in improving the financial position of borrowers, students would benefit from obtaining the lowest cost financing at the time of disbursement (while they are enrolled) rather than refinancing after graduation. The SELF loan program was created by the Legislature to ensure that all students had access to financial aid resources to fund the full cost of attendance of pursuing a postsecondary education. Over time, however, the proportion of the cost of attendance that a SELF Loan covered has declined due to increases in postsecondary prices and the SELF program's loan limits' inability to increase in a timely fashion at equivalent levels. Tying the SELF Loan limits to the cost of attendance, as was originally intended, less other financial aid and with limits determined annually by the Office of Higher Education, would ensure that the program's loan limits adjust to better meet the financial needs of students pursuing a postsecondary education every year.

At the federal level, changes to the federal preferred lender law should be pursued that permit institutions to provide information to students about state-affiliated student loan programs on their financial aid award letter. Historically, state-affiliated student loan programs were packaged with the students' grants, scholarship, and federal loans because they provided the lowest cost option to all students regardless of their credit score. Providing students with greater access to the SELF Loan program would reduce the number of students taking out higher interest rate loans, and reduce the need for students to refinance following graduation.

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# Appendix A

**Table 5:** Suggested Changes to the Federal Preferred Lender Law

<p align="center"><b>Public Law 110 - 315</b>  <b>Higher Education Opportunity Act (Draft Revisions)</b></p> <p align="center"><b>PART E—LENDER AND INSTITUTION REQUIREMENTS RELATING TO EDUCATION LOANS</b></p> <p align="center"><b>SEC. 151. DEFINITIONS.</b></p>	
Existing Language	Proposed Language
<p>(8) PREFERRED LENDER ARRANGEMENT.—The term “preferred lender arrangement”—</p> <p>(A) means an arrangement or agreement between a lender and a covered institution or an institution-affiliated organization of such covered institution—</p> <p>(i) under which a lender provides or otherwise issues education loans to the students attending such covered institution or the families of such students; and</p> <p>(ii) that relates to such covered institution or such institution-affiliated organization recommending, promoting, or endorsing the education loan products of the lender; and</p> <p>(B) does not include—</p> <p>(i) arrangements or agreements with respect to loans under part D of title IV; or</p> <p>(ii) arrangements or agreements with respect to loans that originate through the auction pilot program under section 499(b).</p>	<p>(8) PREFERRED LENDER ARRANGEMENT.—The term “preferred lender arrangement”—</p> <p>(A) means an arrangement or agreement between a lender and a covered institution or an institution-affiliated organization of such covered institution—</p> <p>(i) under which a lender provides or otherwise issues education loans to the students attending such covered institution or the families of such students; and</p> <p>(ii) that relates to such covered institution or such institution-affiliated organization recommending, promoting, or endorsing the education loan products of the lender; and</p> <p>(B) does not include—</p> <p>(i) arrangements or agreements with respect to loans under part D of title IV;</p> <p>(ii) arrangements or agreements with respect to loans that originate through the auction pilot program under section 499(b); <u>or</u></p> <p><u>(iii) education loans made under a State-Based Loan Program.</u></p>

(9) PRIVATE EDUCATION LOAN.—  
The term “private education loan” has the meaning given the term in section 140 of the Truth in Lending Act.

(9) PRIVATE EDUCATION LOAN.—  
The term “private education loan” has the meaning given the term in section 140 of the Truth in Lending Act.

(10) STATE-BASED LOAN PROGRAM.— The term “State-Based Loan Program” —

(A) means an education loan program that—

is provided by a state agency, state authority, or not for profit corporation, separately or jointly;

makes loans not funded, insured or guaranteed by the federal government; and

is authorized or established by state statute and is fully or partially funded by state funds or tax-exempt indebtedness issued pursuant to requirements of the Internal Revenue Code (Title 26 of the United States Code).