Washington State Student Loan Report

January 2023

Introduction

RCW 28B.93.020 (HB 1736) passed in 2022, directing Washington Student Achievement Council (WSAC) to "consult with the office of the state treasurer and the state investment board to design a student loan program to assist students who need additional financial support to obtain a postsecondary education."

WSAC convened members of the Office of the State Treasurer, the State Investment Board, and others to discuss the national landscape of state student loan programs and their features, including balancing self-sustainability and borrower friendliness, loan origination, loan servicing, and merits and demerits of an actuarial analysis and that of financial modeling in determining sustainability.

The following report provides:

- A brief summary of the recent legislation.
- A description of WSAC's process to convene stakeholders for purposes of carrying out the statutory directive.
- A summary of discussions including the national context of the state student loans.
- Recommendations and considerations to the Legislature.

Statutory Requirements and Considerations

The statute requires consideration of the following features for the state student loan design:

- Interest rate not exceeding one percent
- Self-sustainability
- Eligibility:
  - Students in undergraduate or graduate programs. For graduate programs, specifically those that have workforce shortages or are considered high demand.
  - Students with a median family income (MFI) of 100% or less of the state MFI.
  - Students enrolled on at least a half-time basis.
- Origination may be contracted to one or more state based financial institutions
- Loan servicing may be provided by a third-party entity.
- Alignment with the Washington College Grant.

In addition, the statute required the group to make recommendations on the following:

- Terms of the loan:
  - Loan limits
  - Grace periods
- Terms and administration of a repayment program:
  - Repayment options such as standard loan repayment contracts
  - Income based repayment plans
  - Terms of loan forgiveness
- Types and characteristics of students eligible to participate
- Appeals process

State Student Loan Meeting Description and Process

WSAC convened members of the Office of the State Treasurer, the State Investment Board, national experts from Education Solution Partners and SL Capital Strategies, representatives from institutions of higher education, Office of Financial Management and legislative staff (See appendix for details of organizations that were invited and participated) on December 21st, 2022, to:

a) Hear from national experts on the national context related to student loan programs, with a focus on loan programs serving students with no or low credit ratings.

b) Discuss future strategies for Washington, keeping in mind the statutory requirements and prevailing national framework around low-interest student loan programs.

After hearing a general overview of the state student loan programs in the U.S., meeting participants considered the following discussion questions:

1. Critical design elements pertaining to sustainability and equity:
   - What design elements are important to consider in shaping the financial performance and the sustainability of an underlying loan fund?
   - What design elements must be considered to increase equity, i.e., borrower friendliness, especially as compared to the federal student loan program?
2. Considerations regarding loan origination:
   - What components make up loan origination?
   - Who is the originator in state and federal student loan programs today?
3. Considerations in determining sustainability and scale :
   - What are the merits and demerits of an actuarial analysis compared to financial modeling in determining sustainability of loan programs?
   - Based on an understanding of the few low-interest student loan programs among states, what could be the scale of a Washington State program based on annual return to fund?

Overview of National Context and Meeting Discussions

Nationally, most state student loan programs are credit-based and managed by state quasi-public authorities. Three criteria considered for credit-based loans are:

- FICO scores - Minimum FICO score of 670
- Requirement of co-signers
- Eligibility based on school type – two-year and/or four-year schools

Georgia's Student Access Loan (SAL) is an example of a need-based 1% loan[1]. State appropriations, amounting to around $26 million yearly, primarily fund this program. Approximately 31% of SAL borrowers default on their loans after three years of entering repayment. This default rate is about three times higher than federal loan repayment default rates. SAL does not offer payment adjustments based on borrowers' income.

[1] GA Performance Audit Student Access Loan Program.pdf

Discussion on critical design elements pertaining to equity and self-sustainability

The national experts participating in the meeting shared a few design elements important to shaping borrower friendliness:

- Easy access to loans: This could be achieved by reliance on schools to help disseminate information on availability of loan and ensuring ease in completing formalities to access loans
- Repayment of loan: Being able to afford the payment through options such as deferment, forbearance and income-based repayment
- Low interest rates, such as 1%: A policy consideration is the residency status of borrowers after completion of college

They also shared a few design elements that can influence sustainability of the loan program:

- Cost of operations in relation to earnings: Typically, administration and other costs of operation are about 1%. This means that all the interest gained in a 1% loan program would go toward costs. This would compel the program to achieve close to 0% credit losses, which is impossible to achieve.
- To have a sustainable loan program, when the sum of credit losses and administrative costs are subtracted from earnings, the net result must be positive.

The group recognized that the design of the loan will have to balance borrower friendliness with self-sustainability.

Discussion on loan origination and servicing

Loan origination is the qualification and verification process that begins a new loan. Loan servicing begins the moment loan origination ends and a borrower is approved. Loan servicing involves collecting the borrower's payments and distributing them to necessary parties. Most states use outside organizations to run the operations, including loan application and loan servicing.

Discussion on actuarial analysis and financial modeling

National experts shared that an actuarial analysis is a projection-based, detailed analysis of asset to liability that is conducted based on a very detailed design. These kinds of analysis are expensive and could cost hundreds of thousands of dollars.

Most state student loan programs prefer to do financial models with financial consultants which are built based on historical data, and as the program rolls out, current program data is collected to supplant peer data. Financial modeling costs range from $50,000 to $100,000.

Recommendations

Based on discussions, WSAC offered the following recommendations in the areas of policy and practice.

Policy area

- Clear identification of goals of the loan program that include defining self-sustainability, which could lead to solidifying other design elements geared toward decreasing or increasing borrower friendliness.

- A 1% interest loan that is sustainable forever will need state appropriations consistently, or a capital contribution of $150 million would provide an annual lending amount in the low single digits of millions of dollars.
- The design elements will be a lot more borrower-friendly if self-sustainability is redefined as a target life cycle of the fund for 5-10 years.

Practices and guidance

- The default repayment method should be income-based repayment, and the program should provide for shorter time period for forgiveness if income is below repayment level based on the language in statute that says that borrower benefits must be better than federal loan programs.
- The loan program should have a user-friendly application, as well as award and payment process.
- The program should be evaluated to assess its impact on student access and success.

Meeting Invitees and Attendees

WSAC held a 90-minute meeting on Dec. 21, 2022. Stakeholders that were invited and attended the meeting included:

Organizations/ Agencies Invited	Meeting Attendance
Office of State Treasurer	Yes
State Investment Board	Yes
Education Solution Partners	Yes
SL Capital Strategies	Yes
Office of Financial Management	Yes
Senate Non-Partisan Policy Staff	Yes
Senate Caucus Policy Staff	Yes
Senate Fiscal Staff	No
House Non-Partisan Policy Staff	No
House Caucus Policy Staff	No
House Fiscal Staff	No
Council of Presidents	No
State Board of Community and Technical Colleges	Yes
Independent Colleges of Washington	Yes

About the Washington Student Achievement Council

The Washington Student Achievement Council is committed to increasing educational opportunities and attainment in Washington. The Council has three main functions:

- Lead statewide strategic planning to increase educational attainment.
- Administer programs that help people access and pay for college.
- Advocate for the economic, social, and civic benefits of higher education.

The Council has ten members. Four members represent each of Washington's major education sectors: four-year public baccalaureates, four-year private colleges, public community and technical colleges, and K-12 public schools. Six are citizen members, including two current students (one graduate student and one undergraduate student).

If you would like copies of this document in an alternative format, please contact the Washington Student Achievement Council at:

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