

H B

363

# HOUSE COMMITTEE REPORT

(7)

Date referred: 1/15/88

FURTHER REFERRALS: Finance

DATE: 3-9-88

The Health, Education and Social Services Committee has considered HB 363

"An Act relating to conditions of scholarship loans."

**RECOMMENDS:**

- replace with \_\_\_\_\_  the same title
- attached amendment(s)  a new title
- do pass
- do not pass
- no recommendation
- individual recommendations
- additional referral to the \_\_\_\_\_ Committee

**ADOPTS:**  \_\_\_\_\_ letter of intent

**ATTACHES NEW FISCAL NOTE(S):**

- fiscal impact  same as previous fiscal note published \_\_\_\_\_
- zero fiscal note  same as previous zero fiscal note published \_\_\_\_\_
- zero with analysis

**SIGNING DO PASS:**

**SIGNING OTHER RECOMMENDATIONS:**

Dave Dooly

Deuce Shalley - Re-consider additional interest provision

Auto Kopman

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Bill Hudson - NO Rec.

Mr. Kennedy / no rec

Bill E. Bell - No Rec

Ellis - No Rec.

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Auto Kopman  
Co-Chairman's signature

Ellis

# STATE OF ALASKA THE LEGISLATURE

POUCH Y - STATE CAPITOL  
JUNEAU, ALASKA 99811  
907-465-3800

## LEGISLATIVE AFFAIRS AGENCY LEGISLATIVE REFERENCE LIBRARY

May, 1988

Copies of minutes listed below were originally included in this file. The minutes are available on the STAIRS database CMPR. In order to save space copies of minutes have not been left in the files.

Mary Van Nimwegen

H HESS	2-26-88	8:30 a.m.
H HESS	3-9-88	8:30 a.m.

FISCAL NOTE

REQUEST:

Revision Date: \_\_\_\_\_  
Title: RE: Conditions of Scholarship  
Loans  
Sponsor: Sund, Frank, Koponen, Navarre  
Requestor: \_\_\_\_\_

Agency Affected: Education  
BRU: Postsecondary Commission  
Components: Student Loan Program

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 88	FY 89	FY 90	FY 91	FY 92	FY 93
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	N.A.	-0-	-0-	-0-	-0-	-0-
CAPITAL						
REVENUE				52.7	260.0	836.7

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER				(52.7)	(260.0)	(836.7)
TOTAL				(52.7)	(260.0)	(836.7)

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : (Attach a separate page if necessary)

See Attached

Prepared by: Kerry D. Romesburg, Executive Director Phone: 465-2854  
Division: Commission on Postsecondary Education Date: 1/22/88

Approved by Commissioner: \_\_\_\_\_ Date: \_\_\_\_\_  
Agency: \_\_\_\_\_

Distribution (by preparer):  
Legislative Finance  
Legislative Sponsor  
Requestor  
Office of Management and Budget  
Impacted Agency(ies)

HB 363  
Revised Analysis of Fiscal Impacts

Impact on Borrower:

1. Interest accrual during in-school periods will increase the total indebtedness by that accumulated interest amount. The amount of the accrued interest would vary with the amount of the loan and the time spent in school after borrowing.

2. Example:

(a) \$1,000 borrowed (one time only)

<u>Years in School</u>	<u>Additional Interest</u>	<u>Additional Monthly Payment</u>
1 year	\$ 60.00	\$0.50
2 years	\$140.00	\$1.17
4 years	\$300.00	\$2.50

(b) \$5,500 borrowed each year

<u>Years in School</u>	<u>Total Debt</u>	<u>Additional Interest</u>	<u>Additional Monthly Payment</u>
1 year	\$ 5,500	\$ 330.00	\$ 2.25
2 years	\$11,000	\$1,100.00	\$ 9.17
4 years	\$22,000	\$3,960.00	\$33.00

(c) Total repayment after 10 years

<u>Loan</u>	<u>Total Repaid Current Program</u>	<u>Total Repaid Proposed</u>
\$22,000	\$33,791.60 @ \$281.60 per month	\$37,751.60 @ \$314.60

3. Forgiveness impact will not be realized for a number of years.

HB 363  
Revised Analysis of Fiscal Impacts

Assumptions:

1. Borrowers time in school will approximate:

1 year	15%
2 years	22%
3 years	35%
4 years	21%
5 years	5%
6 years	2%
	100%

2. Loan volume is arbitrarily set at figures used for previous analyses. Actual volume may vary substantially, but relationship of fiscal impacts will remain proportionate.
3. Loan default rate and repayment patterns may be altered by the additional debt burden of interest accrual, but any estimate of these impacts is left out of this analysis.

Analysis:

## YEARLY FISCAL IMPACT OF AMENDMENTS

(1) <u>Year</u>	(2) <u>Loan Volume</u>	(3) <u>Forgiveness</u>	(4) <u>Cumulative</u>	(5) <u>In-School Interest</u>	(6) <u>Cumulative</u>
1988-89	\$ 80.3	None		None	
1989-90	80.7	None		None	
1990-91	81.0	None		(52,656)	
1991-92	82.9	None		(259,967)	(259,967)
1992-93	85.3	None		(836,708)	(1,096,675)
1993-94	87.3	None		(1,710,679)	(2,807,354)
1994-95	88.4	None		(2,677,189)	(5,484,543)
1995-96	88.4	285,739	285,739	(3,694,258)	(9,178,801)
1996-97	88.4	812,908	1,098,647	(4,727,733)	(13,906,534)
1997-98	88.4	1,821,711	2,920,358	(5,784,394)	(19,690,928)
1998-99	88.4	3,119,056	6,039,414	(6,863,481)	(26,554,409)
1999-00	88.7	4,487,042	10,526,456	(7,958,642)	(34,513,051)
2000-01	91.2	5,684,418	16,210,874	(9,008,659)	(43,521,710)
2001-02	93.0	6,597,344	22,808,218	(9,906,280)	(53,427,990)
2002-03	94.2	7,052,426	29,860,644	(10,435,046)	(63,863,036)
2003-04	95.1	7,237,560	37,098,204	(10,666,587)	(74,529,623)
2004-05	96.2	7,356,249	44,454,453	(10,805,589)	(85,335,212)
2005-06	97.3	7,425,482	51,879,935	(10,894,032)	(96,229,244)
2006-07	98.5	7,462,909	59,342,844	(10,966,069)	(107,195,313)
2007-08	99.5	7,472,066	66,814,910	(11,014,921)	(118,210,234)
2008-09	100.5	7,483,554	74,298,464	(11,041,354)	(129,251,588)
2009-10	101.5	7,518,828	81,817,292	(11,051,705)	(140,303,293)
2010-11	102.7	7,587,969	89,405,261	(11,054,544)	(151,357,837)



ALASKA STATE LEGISLATURE  
HOUSE OF REPRESENTATIVES  
RESEARCH AGENCY

P.O. Box Y, State Capitol  
Juneau, Alaska 99811-3100  
Mail Stop 3100  
(907) 465-3991

September 9, 1987

MEMORANDUM

TO: Representative John Sund  
ATTN: Shari Kochman  
FROM: David Teal, Director *Teal*  
RE: State Subsidy of Student Loans  
Research Request 88.038

You asked us to calculate the effective State subsidy of Alaska student loans under three scenarios:

1) the pre-1987 program, which offered loans:

- at an interest rate of eight percent;<sup>1</sup>
- with no interest accrued while the student remained in school or during a one-year grace period after completion of schooling; and
- with a forgiveness provision which reduced the debt by ten percent--to a maximum of 50 percent--for each year in which a successful student resided in Alaska following graduation.

2) the current program, which offers loans:

- at an interest rate of eight percent;
- with interest accruing upon graduation (i.e., no grace period); and
- no forgiveness provision.

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<sup>1</sup>Loans were offered at an interest rate of five percent prior to 1986. I have not included the older program in this discussion, but will do so if you wish.

3) a proposal which would offer loans:

- on which eight percent annual interest would accrue from the date of the loan; and
- with the forgiveness provisions that existed prior to the 1987 legislation.

Table 1 provides the information you requested for the three options and for loans without deferment or forgiveness subsidies. The table is divided into two sections--the left side refers to loan provisions as they relate to a single loan; the right side contains adjustments for default and forgiveness, thereby presenting program statistics rather than statistics for an individual loan. In both cases, subsidies are computed by comparing the total loan repayment with the amount the State would recover on an unsubsidized loan.<sup>2</sup> Default adjustments simply reduce the State's recovery by 16.8 percent (the current default rate for the program); adjustments for forgiveness assume that the past rate of forgiveness--one-sixth of all money loaned--continues.

The table indicates that individual loans could receive a State subsidy of 50 percent under your proposal, compared with a 16.8 percent subsidy under the current program. However, because all loans are subject to deferment provisions while only one-sixth of principal is expected to be forgiven, adjustments must be made in order to fairly compare the effect of the forgiveness and deferment provisions. After adjusting for participation rates, one can see (in the right side of the table) that the forgiveness provision is less costly to the State than deferment of interest (27.9 percent subsidy vs. 30.8 percent subsidy). In dollar terms, your proposal would cost about \$6.6 million per year vs. the \$8.4 million cost of interest deferment (assuming a \$60 million per year loan program).

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<sup>2</sup>Effective interest rates are provided for individual loans, but because the effective interest rate is affected by the timing of payments, I am not able to calculate effective interest rates for program provisions without making a series of unsupportable assumptions. Some assumptions were necessary. For example, I have assumed that all loans are for \$20,000 for a four-year curriculum, and that there are no defaults by students who take advantage of forgiveness provisions.

TABLE 1  
 SUBSIDY CALCULATIONS FOR VARIOUS STUDENT LOAN PROVISIONS  
 Applicable to Loans of Two \$2,500 Installments in each of Four Successive Years  
 at an Interest Rate of Eight Percent per Year

	Individual Loans				Program Statistics			Annual cash flow for a \$60 million per year Loan Program (in millions)			
	Amount Recovered by State	Percent Recovered	Percent Subsidy	Effective Interest Rate	Default Rate= 16.8%	Amount Recovered by State*	Percent Recovered	Percent Subsidy	Amount Recovered by State	Net Cost	Cost Excluding Default
No Subsidy (no deferment no forgiveness)	\$37,890	100.0%	0.0%	8.00%		31,524	83.2%	16.8%	\$49.9	\$10.1	\$0.0
Old Program (5 year deferment with forgiveness)	14,559	38.4%	61.6%	-20.87%		22,466	59.3%	40.7%	35.6	24.4	14.3
Current Program (4 year deferment no forgiveness)	31,535	83.2%	16.8%	3.94%		26,237	69.1%	30.8%	41.5	18.5	8.4
Proposal (no deferment but forgiveness)	18,945	50.0%	50.0%	-11.85%		27,331	72.1%	27.9%	43.3	16.7	6.6

\*These amounts are adjusted for default (16.8 %) and for application of the forgiveness provision (1/6 of principal). Default is assumed to be nonexistent for all loans forgiven.

Prepared by the House Research Agency, September 1987 (08-03-87-03; 88.03B).

I believe the table answers your questions, but this memorandum would be incomplete without the following comments.

The numbers presented are approximations. I have had to make some simplifying assumptions concerning default and forgiveness. In addition, I have avoided complexities such as the relationship between loan balance, interest rate and the default rate; the fact that not all loans are made to students who enter or remain in a four-year curriculum; and changes in funding levels or economic conditions. The table may serve as a guide, but you should be aware that the analysis is not highly sophisticated.

As you know, interest deferment applies to all borrowers while forgiveness applies only to those borrowers who both successfully complete their curriculum and who return to Alaska for a number of years. I have not discussed political or philosophical issues such as targeting groups of borrowers, the interchangeability of deferment and higher interest rates, or the possibility of providing incentives to return to Alaska or to use the federal student loan program instead of the Alaska program. The spreadsheet developed to produce the information contained in Table 1 can be used for these purposes, and I offer the spreadsheet and/or our assistance in investigating these issues. I have attached a summary of the spreadsheet output to this memorandum.

In a digression from the focus of this project, I was discussing the bonding provisions of the 1987 legislation with Kerry Romesburg, executive director of the Postsecondary Commission, who voiced some concern that no bonds may be issued. Although the legislature gave the authority to bond, they did not direct that bonds be used to finance the program. If bonds are not issued, it could have an impact on the capital and/or operating budgets. I would be pleased to do some further checking on this subject if you wish me to do so.

You asked for 25-year projections of State costs. Given the level of sophistication of the analysis to date, I hesitate to do more than multiply the "net cost" figures in Table 1 by 25. Doing so produces the following results:

no subsidy	\$252 million
old program	610 million
current program	462 million
proposal	417 million

If you have any questions or would like us to do additional work, please call me.

Attachment

STUDENT LOAN ANALYSIS

Nominal Interest Rate: 8.00%  
 Interest Deferred While in School? 1 (0=no;1=yes,2=no grace year)  
 Forgiveness (Years): 5

Years Until Repayment	Annual Loan	Balance	Balance + Interest
5	\$5,000	\$5,000	\$5,309.18
4	\$5,000	\$10,000	\$11,059.02
3	\$5,000	\$15,000	\$17,286.09
2	\$5,000	\$20,000	\$24,030.01
1	\$0	\$20,000	\$26,024.49

Loan Balance at First Payment: \$20,000.00  
 Monthly Payment \$242.66  
 PSC Interest Computation: \$9,118.62  
 PSC Interest Forgiven: \$0.00

Actual  
 Interest Due: \$4,723.10  
 Interest Paid: \$4,723.10  
 Interest Forgiven: \$0.00  
 Principal (+ Deferred Int.) Forgiven: \$10,163.79  
 Principal (+ Deferred Int.) Repaid: \$9,836.21  
 Prin. and Int. Recovered: \$14,559.31  
 Effective Interest Rate: -20.87%

Prepared by the House Research Agency 09-Sep-87

Payment Number	Balance	Payment	Interest	Principal	Balance
		-26024			
1	20,000.00	242.66	133.33	109.32	19,890.68
2	19,890.68	242.66	132.60	110.05	19,780.63
3	19,780.63	242.66	131.87	110.78	19,669.84
4	19,669.84	242.66	131.13	111.52	19,558.32
5	19,558.32	242.66	130.39	112.27	19,446.05
6	19,446.05	242.66	129.64	113.01	19,333.04
7	19,333.04	242.66	128.89	113.77	19,219.27
8	19,219.27	242.66	128.13	114.53	19,104.74
9	19,104.74	242.66	127.36	115.29	18,989.45
10	18,989.45	242.66	126.60	116.06	18,873.39
11	18,873.39	242.66	125.82	116.83	18,756.56
12	18,756.56	242.66	125.04	117.61	18,638.95
13	16,638.95	242.66	110.93	131.73	16,507.22
14	16,507.22	242.66	110.05	132.61	16,374.62
15	16,374.62	242.66	109.16	133.49	16,241.12
16	16,241.12	242.66	108.27	134.38	16,106.74
17	16,106.74	242.66	107.38	135.28	15,971.47
18	15,971.47	242.66	106.48	136.18	15,835.29
19	15,835.29	242.66	105.57	137.09	15,698.20
20	15,698.20	242.66	104.65	138.00	15,560.20

Prepared by the House Research Agency, September 1987 (88.038; 08-03-87-43).

TITLE: STUDENT LOAN PROPOSAL

DATE: 2/15/88

SPONSOR: HAYES THROUGH GRAIF, SMITH, HOFF, WILLIAMS, ROWSE

WHEREAS, the students of UAF are supporting amending HB 363, to reinstate the forgiveness clause in the Alaska State Student Loan, and the original intent to benefit student that remain in/return to Alaska after graduation, and,

WHEREAS, approximately nine percent of borrowers have actually qualified for forgiveness, and,

WHEREAS, no state in the nation charges interest on student loans while a student is in school, and,

WHEREAS, students feel that interest accruing while in school is a unjust economic burden, and,

WHEREAS, students support a six month grace period on the interest of the loan, and repayment starting one year after graduation, the same terms as the National Guaranteed Student Loan, and,

WHEREAS, with eight percent interest accruing during school, students that do not qualify for forgiveness for any number of reasons will end up owing an enormous debt.

THEREFORE BE IT RESOLVED that the students of the University of Alaska Fairbanks unanimously support amending HB 363 to reinstate the forgiveness clause as it was originally worded implementing a six month grace period after graduation on interest accrual.

BE IT FURTHER RESOLVED that this proposed amendment to HB 363 be forwarded to the Governor of Alaska, members of the Alaska State Legislature, and members of the Alaska Post Secondary Education Commission.

SENATE PRESIDENT

SENATE CLERK

ASUA PRESIDENT

Greg Graif 2-15-88

Kristen M. Anderson 2-15-88

John Foster Wallace 2/15/88

# STATE OF ALASKA

## ALASKA COMMISSION ON POSTSECONDARY EDUCATION

BILL SHEFFIELD, GOVERNOR

POUCH FP  
JUNEAU, ALASKA 99811  
PHONE: (907) 465-2854

### MEMORANDUM

TO: Members of the Alaska Commission on Postsecondary Education

Ms. Alice Bosshard, Chair	Senator Joe Josephson
Ms. Patricia Abney	Ms. Laura Kelley
Mr. John Chenoweth	Representative Niilo Koponen
Dr. Patricia Clark	Mr. Kenneth Knox
Mr. Gordon Evans	Ms. Barbara Shaffer
Mr. John Havelock	Ms. Bettye Smith
Mr. Mark Helmericks	Ms. Barbara Thompson

FROM: Kerry D. Romesburg, Executive Director  
Alaska Commission on Postsecondary Education

DATE: February 24, 1988

### HB 363 Position Recommendation

The Alaska Commission on Postsecondary Education has not met and formalized a position on HB 363 and will not meet until March 25-26, 1988. The following is only staff recommendation and analysis and does not represent an agency position.

#### Sectional Analysis

Section 1 of the bill provides for interest on a loan to accrue the entire time a loan is held, and to charge this accrued interest to the borrower. This is a considerable change from the current policy of "waiving" the accrued interest while a borrower is in school or in a deferment classification.

Section 2 provides that although interest accrues the entire time a loan is held, payment of that interest shall be deferred until the borrower is out of school or out of deferment.

Section 3 reinstates the 50% "forgiveness" program. This is the same forgiveness which was deleted last year.

Section 4 repeals the current language under which interest is "waived" while a borrower is in school or in deferment.

Discussion

There are three principal issues to be considered in deliberations on HB 363. These are: impact of student loan bonding, student indebtedness level, and benefits of a forgiveness program.

Impact of student loan bonding. The handling of loan forgiveness changes when the loans are pledged against bond issues rather than simply being held by the State. If the State holds the notes and wishes to forgive, or write-off, portions of indebtedness, there is no immediate problem. The income stream to be generated by the portfolio is impacted in future years, but that is the only fiscal impact.

If the portfolio is pledged against bond issues, forgiving portions of indebtedness has both an immediate and a long-term impact. The immediate effect is that it takes a larger portion of the portfolio to secure an issue. Uncertainty of income is created. Secondly, the long-term cash flow is diminished, thereby reducing the program's ability to support multiple bond issues.

This can be avoided or off-set in a couple of ways. One, the State could annually appropriate to the loan fund, the amount of forgiveness for that year. This done, there is no diminution of income stream.

Second, the State could impose new conditions which would generate enough program revenue to off-set the costs of forgiveness. Imposing repayment of interest accrued while in school or deferment accomplishes this.

Student indebtedness. The size of student loan indebtedness has long been a concern of the Postsecondary Commission. The additional interest indebtedness which HB 363 imposes on borrowers can be substantial. For example, instead of a student being in debt \$22,000 at graduation, that same student would owe \$25,960 at graduation under this bill (an increase of 18%).

Certainly, the impact is less on vocational borrowers, since they usually only have a year, or less, of in-school status. The greatest impact would be on a student who attends college and graduate school.

Benefits of a forgiveness program. The purpose of forgiveness is to encourage or entice a student to live in Alaska after completion of postsecondary education studies. A very real question exists as to the effectiveness of such a program. Certainly, the higher the debt burden and the more generous the forgiveness, the more effective it would seem. When the Commission surveyed graduates in 1984, it was found that those choosing to live in Alaska did so principally because "Alaska is home" or

Members of the Alaska Commission on  
Postsecondary Education  
February 24, 1988  
Page 3

"job availability". Only 8.4% of the respondents living in Alaska indicated that loan forgiveness was a principal determinant in their decision to live here.

The other point which should not be missed is that under the past forgiveness program only about one person in six actually qualified for and received forgiveness. When making a loan, most borrowers assumed they would only pay back half of what they were borrowing, but experience proved that to be quite misleading.

#### Recommendation

The Executive Director recommends the Commission formally adopt a position in opposition to charging the student borrower for interest accrual during in-school and deferment periods and also in opposition to reinstatement of a general forgiveness program. The reasoning being that interest accrual greatly increases the debt burden for all borrowers, and a forgiveness program only benefits a small number of borrowers, and then probably rewards most of those for something they would have done without forgiveness.

TABLE 1  
 SUBSIDY CALCULATIONS FOR VARIOUS STUDENT LOAN PROVISIONS  
 Applicable to Loans of Two \$2,750 Installments in each of Four Successive Years  
 at a Simple Interest Rate of Eight Percent per Year

Effective Interest Rates are based on comparison with  
 money loaned at a rate of 8 % compounded monthly, so that  
 total principal and interest = \$41,678.85

	Program Statistics									
	Individual Loans				Default Rate= 17.3%			Annual cash flow for a \$60 million per year Loan Program (in millions)		
	Amount Recovered by State	Percent Recovered	Percent Subsidy	Effective Interest Rate	Amount Recovered by State*	Percent Recovered	Percent Subsidy	Amount Recovered by State	Net Gain	Net Bond Payments from General Fund**
No Subsidy (no deferment no forgiveness)	\$37,752	90.6%	9.4%	5.78%	31,221	74.9%	25.1%	\$85.1	\$25.1	\$36.9
Old Program (5 year deferment with forgiveness)	16,016	38.4%	61.6%	-20.87%	22,075	53.0%	47.0%	60.2	0.2	61.8
Current Program (4 year deferment no forgiveness)	33,792	81.1%	18.9%	3.39%	27,946	67.1%	32.9%	76.2	16.2	45.8
Proposal (no deferment but forgiveness)	18,876	45.3%	54.7%	-15.32%	26,016	62.4%	37.6%	71.0	11.0	51.0

\*These amounts are adjusted for default (17.3%) and for application of the forgiveness provision (1/6 of principal and interest).  
 Default is assumed to be nonexistent for all loans forgiven.

\*\*Assumes bonds in the amount of \$60 million are issued at 6% for 20 years.



ALASKA STATE LEGISLATURE  
HOUSE OF REPRESENTATIVES  
RESEARCH AGENCY

P.O. Box Y, State Capitol  
Juneau, Alaska 99811-3100  
Mail Stop 3100  
(907) 465-3991

March 2, 1988

MEMORANDUM

TO: Representative John *ton PA*  
ATTN: Shari Kochman  
FROM: David Teal, Director *ca*  
RE: Alaska Student Loan Program: Cost of Various Options  
Research Request 88.196

When the student loan program began in 1971, the program offered loans at an interest rate of five percent and forgiveness of up to 40 percent of principal and accrued interest, with the amount forgiven dependent upon length of residency after completion of school. Generally, the program became more liberal over the years, eventually offering up to \$6,000 per year for undergraduate study and up to 50 percent forgiveness, with no accrual of interest until the first payment became due one year after completion of school. However, the 1986 Legislature raised the interest rate to eight percent and reduced the maximum loan amount to \$5,500 for undergraduates. In 1987, the forgiveness provision was deleted and the interest deferral period was modified to eliminate the one-year grace period.

You asked us to compare the cost of offering student loans under HB 363 with the cost of offering loans under the current program and under the forgiveness and interest accrual provisions in effect in 1986. HB 363 would reinstate forgiveness and eliminate provisions that allow students to avoid the accrual of interest while in school.

Table 1 compares various program options. The table may be more easily understood if divided into three parts. Columns 1 through 4 relate to an individual borrower taking full advantage of forgiveness provisions (if available). Columns 5 through 7 make adjustments for default and for application of the forgiveness provision. They indicate the degree of subsidy involved in each of several options--relative to a loan offered at eight percent (compounded monthly) with no default, no forgiveness, and

with interest accruing from the date of the loan.<sup>1</sup> Columns 8 through 10 present similar information, but as a cash flow rather than a percentage. The cash flow figures assume that \$60 million per year is loaned to students.

The "no subsidy" option indicates that use of simple interest--as opposed to compound interest as would be charged in a standard bank loan--results in a subsidy of 9.4 percent. When combined with a default rate of 17.3 percent, the state could expect to recover about 75 percent of the amount that would be recovered if loans were truly unsubsidized.<sup>2</sup> Column 9 shows that this option would be self-supporting--and could actually return money to the general fund--if the program loaned a constant amount in each year. The simple interest and default subsidies are included in each of the remaining options.

The table shows that the state would recover about five percent more under the current program than under HB 363. The numbers presented are approximations. I have had to make some simplifying assumptions concerning default and forgiveness. In addition, I have avoided complexities such as the relationship between loan balance, interest rate and the default rate; the fact that not all loans are made to students who enter or remain in a four-year curriculum; and changes in funding levels or economic conditions. The table may serve as a guide, but you should be aware that the analysis is not highly sophisticated and that the five percent difference between HB 363 and the current program is within the probable margin of error.

As you know, interest deferment applies to all borrowers while forgiveness applies only to those borrowers who both successfully complete their curriculum and who remain in Alaska for a number of years. The table presents program statistics and does not indicate the fact that those who return to, or remain in, Alaska would be far better off under HB 363 than under current law while those ineligible for forgiveness would be better off under the current program.

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<sup>1</sup>In this analysis, "subsidy" refers to any option that reduces the amount of principal or interest recovered by the state. Forgiveness, default, failure to accrue interest from the date of the loan, and use of simple interest are considered subsidies.

<sup>2</sup>The current default rate is about 17.3 percent. The default rate is affected by collection efforts, economic conditions, the level of payments and several other factors. No attempt has been made to adjust default rates for changes in relevant factors.

Representative Sund  
March 2, 1988  
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I have not discussed the interchangeability of loan term, interest deferment, compound interest and higher interest rates as a means to set a target recovery level. The spreadsheet developed to produce the information contained in Table 1 can be used for these purposes, and I offer the spreadsheet and/or our assistance in investigating these issues.

I have also omitted discussion of (1) the cost, cash flow and other effects of issuing bonds, and (2) the effect that a forgiveness provision and current default rates might have on the ability to fund the student loan program by issuing bonds. I understand that Kerry Romesburg has discussed these issues with you.

TABLE 1  
 SUBSIDY CALCULATIONS FOR VARIOUS STUDENT LOAN PROVISIONS  
 Applicable to Loans of Two \$2,750 Installments in each of Four Successive Years  
 at a Simple Interest Rate of Eight Percent per Year

Effective Interest Rates are based on comparison with  
 money loaned at a rate of 8 % compounded monthly, so that  
 total principal and interest = \$41,678.85

	2	3	4	5	6	7	8	9	10	
	Program Statistics									
	Individual Loans				Default Rate= 17.3%			Annual cash flow for a \$60 million per year Loan Program (in millions)		
	Amount Recovered by State	Percent Recovered	Percent Subsidy	Effective Interest Rate	Amount Recovered by State*	Percent Recovered	Percent Subsidy	Amount Recovered by State	Net Gain	Net Bond Payments from General Fund**
No Subsidy (no deferment no forgiveness)	\$37,752	50.6%	9.4%	5.78%	\$31,221	74.8%	25.1%	\$85.1	\$25.1	\$36.9
Old Program (5 year deferment with forgiveness)	16,016	39.4%	61.6%	-20.87%	22,075	53.0%	47.0%	60.2	0.2	51.8
Current Program (4 year deferment no forgiveness)	33,792	81.1%	18.9%	3.39%	27,946	67.1%	32.9%	76.2	16.2	45.8
HB 363 (no deferment but forgiveness)	18,876	45.3%	54.7%	-15.32%	26,016	62.4%	37.6%	71.0	11.0	51.0

\*These amounts are adjusted for default (17.3%) and for application of the forgiveness provision (1/6 of principal and interest).  
 Default is assumed to be nonexistent for all loans forgiven.

\*\*Assumes bonds in the amount of \$60 million are issued at 6% for 20 years.