

# A Guide to Student Loan Consolidation

## ■ Introduction

If you are reading this, you probably have student loan repayment fast approaching. Fortunately, you have options for repaying your student loans. One of them is referred to as loan consolidation, which you may discover makes perfect sense for your financial situation. Or, after checking out the pros and cons, and examining your future career and life plans, loan consolidation may not be right for you at this point. The important thing is that you are thinking about your future, comparing the different types of consolidation options available, and determining what makes sense for you. Given the time, work and money you've put into your education, this is a smart move.

Of course, you are used to making smart moves. You probably know this already, but going after that undergraduate degree or finishing off that graduate coursework is one of the smartest things you could have done. Sure it's been a ton of hard work, you've made lots of sacrifices and most likely there's a financial burden now placed on you and your family, but in the long-term, your degree will provide a foundation for you to earn more than someone who hasn't earned that credential.

Here's why: A bachelor's degree hanging on your wall will earn you 62 percent more than someone who has only a high school diploma, according to U.S. Census Bureau statistics. And over your lifetime, the gap between your old friend's high school diploma and your bachelor's degree will turn out to be more like a gulf—totaling more than \$1 million. For those who are going after master's degrees or PhDs, the news is just as good: You'll also stand to make more money than those who didn't take the next step.

### Even "some college" is better than none:

the median salary is almost \$5,000 more per year.

#### Median Earnings by Level of Education (2003)

- Professional Degree (MBA, JD, etc): .....\$95,700
- Doctorate Degree (PhD): .....\$79,400
- Master's Degree: .....\$59,500
- Bachelor's Degree: .....\$49,900
- Associate Degree: .....\$37,600
- Some College, No Degree: .....\$35,700
- High School Graduate: .....\$30,800
- Not a High School Graduate: .....\$21,600

Source: Baum, S. and Payea, K. (2004) Education Pays 2004: The Benefits of Higher Education for Individuals and Society. The College Board.

However, you probably don't need to be reminded about the loans you had to take just to get to this point. And if you're reading this, chances are you're trying to figure out how you're going to get by after you graduate, find a good job, take care of your living expenses, pay down those credit card bills, buy a car and start paying off your student loans. No matter how much loan debt you've accumulated, however, take heart because you're not alone: The average for student-loan debt ranges from \$20,000 all the way up to \$40,000, depending on the source of the information. Those are daunting numbers. But for many students, loan consolidation can help them manage their debt, rather than letting it manage them.

**Time Sensitive:**  
Figure this out soon,  
as the rate / structure of  
federal loans are subject  
to change on July 1, 2007.

You might want to make a decision  
before that deadline.

## ■ What is Consolidation?

Though the loan consolidation process and its terminology can be complex and confusing, the basic concept is easy to understand: You take all of your outstanding federal student loans (even if it's just one loan) and bundle them into one new student loan with one monthly payment. The new rate is fixed—meaning it won't change—and the length of the loan can be extended all the way up to 30 years, which can lower the amount of your monthly payments. It's a kind of refinancing of your federal student loans.

Student loan consolidation has grown significantly during the last several years. Students and their families have had to take on more financial burden due to a combination of steep increases in tuition (annual costs rose 35 percent during the last five years) as well as a decline in the amount of federal and state financial aid, including grants, to students. Put another way, this new era is being called "debt for diploma." In turn, loan consolidation has become such a viable and necessary option that some 2.5 million students consolidated their loans in 2005. The U.S. Department of Education predicts that nearly as many students will do the same in 2006.

## ■ What Are the Pros and Cons of Federal Student Loan Consolidation?

There are many good reasons to consolidate your student loans. However, there are other factors that borrowers will need to consider before making their decision.

First, on the positive side. You'll simplify your life with one monthly payment that will come from one lender (and one point of contact if you have any questions). Because you are extending your loan's term (or how many years it's going to take to pay back your consolidated loans), your monthly payment will be lower. That's where the term "payment relief" comes from. Loan terms range anywhere from 10 years all the way up to 30 years. And the interest rate on a federal consolidation loan is fixed—which is unlike variable interest rate loans that can change. Your consolidated loan's interest rate will be equal to the average of all the student loans you want to consolidate, which is then rounded up to the nearest 1/8 percent. The maximum rate your loan can be is 8.25 percent.

## ■ Sample Consolidation for Private Loans:

Let's say you needed to borrow money in your last three years at school.

- **Your junior year**, your costs went up because you studied abroad, and you borrowed **\$10,500 at an interest rate of 8.25%**.
- **Your senior year**, your lighter class load let you work a bit more, so you only needed to borrow **\$5,500, and you got a better rate at 7.28%**.
- You decided to finish that double major and **stayed an extra semester**, so you needed to borrow **another \$9,500 at 8.5%**.

If you **don't** consolidate these loans, your monthly bills for the next **10 years will look like this:**

- **First loan (\$10,500)** – monthly payment: .....\$128.73 – **total cost of loan: .....\$15,447.50**
- **Second loan (\$5,500)** – monthly payment: .....\$64.63 – **total cost of loan: .....\$7,755.19**
- **Third loan (\$9,500)** – monthly payment: .....\$117.79 – **total cost of loan: .....\$14,134.12**

**Total monthly payment: ..... \$311.15**  
**Total cost of all loans, over 10 years: ....\$37,336.81**

If you **do** consolidate, and stretch out your payments for **15 years** instead...

**Total monthly payment: ..... \$217.28 (\$93.87 less),**  
**Total cost of all loans, over 15 years: ....\$52,145.22**

You'll have more than **\$90 a month extra** in your pocket – which may be important when you are starting out with a lower salary and have bills to pay. On the downside, it will take you 5 additional years to pay off the loan, and it will cost you more overall – unless you pay it off sooner as your salary increases.

## ■ Pros & Cons

### Positive +

- One monthly payment (one stamp!)
- One lender to contact
- Lower monthly payment (more cash for food!)
- No fees
- No credit checks
- No prepayment penalties  
(so when you win the lottery, you can just pay it all off!)
- Borrower benefits or "Goodies" – cash back, reduced rates

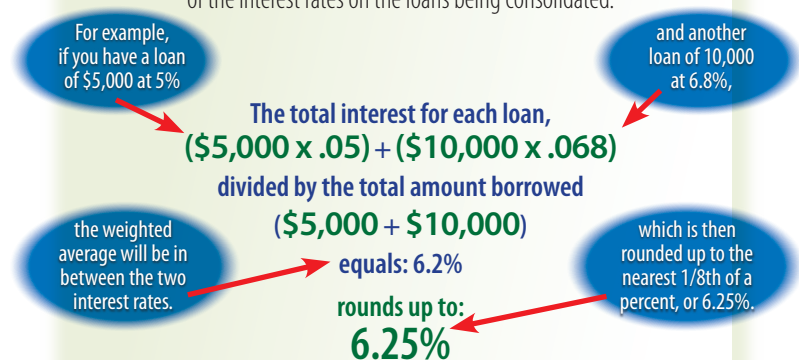
### Negative –

- Takes longer to pay back  
(hopefully before your kids go to college)
- Total cost of the loan is higher
- Locked interest rate = if rates go down, your rate won't change
- Lose benefits (if any) from previous loans

## ■ Federal Consolidation Loan Interest Rates...

### The calculation looks like this:

Consolidation loan interest rates are calculated by taking an average of the interest rates on the loans being consolidated.



You'll notice the consolidation interest rate is closer to 6.8% than to 5% because more money was borrowed at the higher rate. Even though it's rounded up, federal consolidation loan interest rates are capped at 8.25%.

In addition, there are no fees, credit checks or prepayment penalties related to your consolidated loan. And lenders are aggressively courting your business with incentives – called “Borrower Benefits” – that can offer you cash back, reduced rates, principal reductions and other benefits. (See below.) That’s all the good news.

### ■ Borrower Benefits

Many lenders offer incentives to encourage borrowers to choose their loan product. These incentives are commonly referred to as “Borrower Benefits,” and they come in several forms.

● **Automatic** Some Borrower Benefits are “automatic,” meaning that you automatically receive the incentive or benefit without having to qualify.

● **Earned** Some Borrower Benefits are “earned,” meaning that you must qualify for them first. A common earned Borrower Benefit is an interest rate reduction for setting up automatic payments; another is an interest rate reduction for a pre-determined number of on-time payments. Note that “earned” benefits can sometimes be “un-earned” if you stop meeting the requirements. Ask your selected lender for details about borrower benefits, including requirements to qualify and/or to later be disqualified for them.

#### ● Examples of Borrower Benefits can include:

**Interest Rate Reduction:** Usually a percentage by which the interest rate on the consolidation loan will decrease after a certain number of months of ontime payments.

**Principal Reduction:** Usually a percentage of the original principal balance of the loan that is deducted from the amount owed—earned after a certain number of months of ontime payment.

Now for the considerations that can make student loan consolidation not the right choice for everyone. First, you have to realize that by extending the length of your loan period (which does lower your monthly payments) you are adding to the total cost of the loan because of the extra time that interest on your loan is being charged. Put another way: You might end up spending more money in the long run.

Another consideration is that by locking in that one rate, you protect yourself if interest rates rise in the future; however, if interest rates go down, you are still locked in to your rate. Also, some new federal loans already have fixed rates. Consolidating these newer loans keeps the rate fixed, but they might get rounded up a bit. In addition, when you agree to the terms and conditions of your new consolidated loan,

you lose all of the terms and conditions of your previous student loans. That’s important because some benefits contained within your previous loans might not be included, or may be different, in your new consolidated loan. Make sure you carefully read and compare how your original loans stack up against your new consolidated loan.

### ■ What Types of Loans Can Be Consolidated?

Just about any federal loan – whether from the Federal Family Education Loan (FFEL) program or the Federal Direct Loan program – can be consolidated. Another common category of student loans is “private loans”—which come from private lenders such as banks and are not subsidized or guaranteed by the government. These loans cannot be consolidated under federal loan consolidation guidelines, but you can find private consolidation loans.

#### ■ Almost Any Federal Education Loan Can Be Consolidated, Including the Following:

- **Stafford Loans** (“subsidized” and “unsubsidized”)
- **Direct Student Loans / “Ford” Loans** (“subsidized” and “unsubsidized”)
- **Parent Loan for Undergraduate Students (PLUS)**
- **Direct Parent Loan for Undergraduate Students (Direct PLUS)**
- **GradPLUS Loans**
- **Direct GradPLUS Loans**
- **Perkins Loans**
- **Federal Consolidation Loans**
- **Federal Direct Consolidation Loans**

...plus some other less common types of federal loans

Don’t forget to tell your folks – **Parents can consolidate their federal PLUS loans.\***

In fact, it’s a no-brainer. Most new PLUS loans carry an interest rate of 8.50%. Once consolidated, the rate gets reduced to the interest rate cap on consolidation loans: 8.25%. and borrower benefits are often available to reduce borrowing costs even further.

**\*Parents cannot consolidate their loans with a student’s loans - the original individual borrower must be the same person for consolidation loans.**

## ■ Am I Eligible to Consolidate My Loans?

Requirements vary by each lender, so check with them for more information on their “fine print,” but here are some general guides:

- ✓ 1. You have any of the qualifying federal loans.
- ✓ 2. You have total outstanding federal education loan balances of \$7,500 or greater. (This amount can vary from one lender to the next, and some lenders will consolidate lesser amounts.)
- ✓ 3. None of your existing student loans are in default. (If you are in default on a loan, you first need to make repayment arrangements with your lenders before they will consider consolidating them.)
- ✓ 4. You are a U.S. citizen.
- ✓ 5. You are no longer (or are soon to be no longer) enrolled in the program for which you borrowed the loans you want to consolidate. In other words – you must have graduated or dropped out of the program for which you borrowed. For example, you could consolidate your loans from your undergraduate program while you are in graduate school.

## ■ What Are the Different Types of Repayment Options?

In an effort to give student borrowers more flexibility in how they repay their loans, there are four types of payment plans to choose from. In all cases, it’s a good idea to shop around and compare the different repayment plans from lending institutions because terms vary from one lender to the next, and you might be able to get a better deal from another lender.

**The first is the Standard plan**, and it’s pretty straightforward: fixed monthly payments for up to 10 years.

**Second is the Extended plan.** This plan allows you to extend the length of loan up to 30 years. However, each lender may have different repayment terms, which largely depend on the balances of your loans. For example, if your loan balance was less than \$12,000, a lender may allow you up to 12 years to repay your consolidated loan. If your loan balance was more than \$60,000, then your lender would probably give you up to 30 years to pay that back. An important note: other education loans that aren’t being included in your consolidation loan may count toward the “loan balance” calculation that determines the length of repayment for which you qualify.

**The third option is Graduated Repayment.** This plan is best-

suited for someone who needs lower payments during the first couple of years and then will be able to handle higher payments during the remaining years. Again, different lenders offer plans that mix-and-match levels of payments, for example, interest-only payments for the first couple of years, followed by higher payments that pay both the interest and principal. However, any time you take off from paying on the principal of the loan will probably increase the loan’s total amount.

## A fourth option is Income Sensitive / Income Contingent.

In some situations, lenders will base your payments on your monthly income, amount you borrowed, your employment status, and other factors. Your payment will adjust annually as your work situation changes. Requirements and terms will vary with each lender. It’s relatively hard to qualify for this plan, but if your income is going to be very low, you might want to check out this option. As with the Graduated Repayment plan, this plan will probably increase the total cost of the loan (principal + all interest).

## ■ Federal Consolidation vs. Private Consolidation—What’s the Difference?

Federal consolidation loans are a mechanism to refinance federal education loans only. Private consolidation loans are a way to refinance private education loans only. The main difference is that a federal consolidation loan comes with a fixed interest rate that follows a set federal formula, while private consolidation loans come with a market rate that may be fixed or variable.

**If you consolidate both federal and private loans you should make sure to keep them separate – refinancing a federal loan with a private consolidation product will most likely result in a much higher interest charge than you’d pay if you kept it separate.**

Private consolidation loans might be an attractive option for you. Here are some of the benefits you might find:

- Longer repayment term (up to 30 years in some cases)
- Lower monthly payment
- One monthly bill
- Potential release of cosigner from the original private loans... but weigh this decision carefully, as a longer repayment term usually means a greater cost of borrowing (you pay interest for more years). Also, make sure to consider the interest rate on the private consolidation loan versus your existing private loans – rate structures can vary widely.

**Watch Out!**  
The wrong consolidation loan may result in much higher interest charges!

“Extended” is the most common plan.

## ■ When Should I Consolidate?

The answer to that question is primarily based on where you are in your life—whether you're still in school or have become an alumnus. If you're in "repayment" mode, meaning you're all done with full-time school and the student loan bills are starting to come, then you can consolidate now. If you're in a "grace period" (the time right after you graduate but before you have to pay your student loan bills), you can consolidate. If you're still enrolled in the program for which you borrowed, you can't consolidate.

### Time Sensitive:

**July 1st!**

Each year, interest rates for most federal student loans are reset on July 1.

No matter your loan status, however, there is one date on the calendar that you should be aware of: July 1. On that day each year, interest rates for all but the newest federal student loans are reset. Keep an eye out for information about what the new rate will be. Indications

are that it will increase slightly in 2007, so consolidating prior to July 1 will ensure that you consolidate at the rate in place before the change.

So long as your application for federal consolidation is complete and submitted before the deadline, you're good to go. Note however, that in general, it takes between 30 days to 90 days to complete the loan consolidation process. Once your loan is consolidated, your first payment will be due in 60 days.

## ■ What's the Status of My Loan?

Here are some glossary terms you should know:

- **In-School**—When you're still in college as a full-time student.
- **Grace**—The time after graduation when you are not required to start repaying your loan. For Stafford Loans, this is six months; for Perkins loans, it's nine months. (There's no grace period on a PLUS loan.)
- **Repayment**—Following the grace period, this is when you begin repaying your student loans.
- **Delinquency**—When you fail to make a payment when it's due.
- **Deferment**—When your lender allows you to temporarily postpone your payments due to economic hardship.
- **Forbearance**—When your lender allows you to temporarily postpone paying the principal on your loan, though interest on the loan still accrues.
- **Default**—When you fail to make your payments or abide by the terms of your loan. Defaulted loans are reported to credit-reporting agencies, which is really bad for your future credit scores.

## ■ Which lender is right for me?

If you've weighed the pros and cons, and decided that consolidation is right for you, the next step is to pick a lender. Just like when you make any kind of big purchase (for example, a new PC or a car), you need to shop around for the best deal. The federal consolidation market is growing, and it is very competitive. Good deals can be had if you look around. Many lenders offer aggressive incentives — see the section on Borrower Benefits on page 3. As with any type of big financial investment, be sure to do your homework: compare all the types of loans you qualify for, read the fine print on different Borrower Benefits, and run the numbers. And then apply and get back to finding a job, studying for the Bar, enjoying summer. . .

## ■ Can I "Re-Consolidate" My Current Consolidation Loans?

It depends on a couple of factors. The general rule is that you cannot re-consolidate most consolidation loans on their own. The one exception is for loans that were consolidated under the federal Direct Loan Consolidation program, which can be re-consolidated. For all other federal loans, you must have a new loan to add to an existing consolidation loan to re-consolidate. Of course, there are many exceptions and restrictions, so check with your lender for more information.

## ■ Helpful hints:

Don't have any idea what loans you have? Don't worry, you can find out! Go to:

[www.nslds.ed.gov](http://www.nslds.ed.gov)

You'll need to know your FAFSA PIN, which you can retrieve from

[www.pin.ed.gov](http://www.pin.ed.gov)

**2.5**  
**million students**

consolidated their  
loans in 2005

-U.S. Department  
of Education

**ConsolidationComparison.com**

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