Session 48

Electronic Access Conference
Orlando, Florida
Las Vegas, Nevada
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Consolidation Loans: How They Work

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Agenda

1. What are Title IV consolidation loans
2. The Basics
    --Why consolidate, why not
    --Step-by-step flow
3. What are the numbers
4. Take away

What are They?

- New loan comprising (and paying off) existing student loan obligations
- Offered by DL and FFEL eligible lender
- Total of existing principal amount of obligations in new form
- Prior obligations are paid in full
- Established in 1986 for FFEL, 1992 for DL

Loans Eligible for Consolidation, part I

- DL and FFEL Stafford Loans
- Perkins Loans
- Existing DL and FFEL consolidation loans (limited)
- DL and FFEL PLUS
- Health Education Assistance Loans (HEAL)
- Federal Insured Student Loan (FISL)

Loans Eligible for Consolidation, Part II

- Health Professions Student Loans (HPSL)
- Loans for Disadvantaged Students (LDS)
- Nursing Student Loans
- Fed. Supp. Loans for Students (SLS)
- Loans to Assist Students (ALAS)

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The Basics - Advantage to Borrower

- Lock in (fixed) interest rate – (details to follow)
- A longer repayment period – lower monthly payment (details to follow)
- If loans scattered, obtain single holder/servicer; single payment
- Defaulted loan(s) can be consolidated out of default if satisfactory repayment arrangement with holder

The Basics – Any Disadvantages?

- May lose existing incentives offered by holder
- May lose deferment and cancellation rights on Perkins loans
- If consolidate defaulted loans, collection charges are capitalized.
- Special case of spousal consolidation

  --Joint and several liability for combined obligation (it better be love)

  --Deferment only if both are eligible

The Basics – Major FFEL/DL differences

- FFEL single holder rule

  Borrower works with single holder unless unable to get a consolidation loan, or consolidation loan with income-sensitive repayment from that holder

- In-school consolidation – DL only

The Basics - Interest Rate Calculation

- How is the interest rate calculated?

  Weighted average of the interest rates on the loans being consolidated, rounded up to the nearest 1/8 of 1%, capped at 8.25%

Give me an example -

Step 1

- Determine interest rate for each loan included in consolidation
  - --Old vs. new loans
  - --Holder disclosure
  - --Annual interest rate tables

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Give me an example -

Step 2

Multiply each loan by its interest rate for the "per loan weight factor"

Loan #1 4,000 x 5.00 = **20,000.00**

Loan #2 4,000 x 4.17 = **16,680.00**

Loan #3 2,000 x 3.37 = **6,740.00**

Loan #4 1,000 x 3.37 = **3,370.00**

Give me an example -

Step 3

Add the per loan weight factors together

20,000.00

16,680.00

6,740.00

3,370.00

46,790.00

Give me an example -

Step 4

Add the loan amounts together

4,000 x 5.00 = 20,000.00

4,000 x 4.17 = 16,680.00

2,000 x 3.37 = 6,740.00

<u>1,000</u> x 3.37 = 3,370.00

11,000

Give me an example -

Step 5

Divide the "total per loan weight factor" by the total loan amount

$$\frac{46{,}790.00}{11{,}000} = 4.2536363636363636\ldots$$

fixed at 4.375%

(use: .125, .25, .375, .5, .625, .75, .875, 1.0)

Give me an example -

- How would in-school or in-grace status change the fixed rate?

    Rate for underlying variable rate loans would be less this year:

    3.37% would be **2.77%;**

    4.17% would be **3.57%,** etc.

Give me an example -

- STOP

  The result of the weighted average calculation is that the borrower would make a single monthly payment for the consolidation loan equal to the combined payments on the underlying loans (or maybe more due to rounding factor). However if the base of 1.07 for variable rates rises in subsequent years, fixing the rate for the consolidated debt now will be an advantage .

The Basics - Longer Repayment Option

Under $7,500	10 years maximum
$7,500-$10,000	12 years
$10-20,000	15 years
$20-40,000	20 years
$40-60,000	25 years
= or greater than $60,000	30 years

The Basics - General Repayment Options

- Standard
- Graduated
- Extended repayment (>$30,000)
- Income-sensitive
- Income contingent (DL only)

(with or without consolidation)

The Basics - Step-by-Step

- Contact (holder, borrower, consolidator, collection agent, school) – info, options
- App/Note submitted(electronic/paper)
- Verification of loans to be consolidated
- Consolidator does the (final) math
- Consumer information provided, borrower confirms

continued…..

The Basics - Step-by-Step

- Consolidator pays off underlying loans
- Notification of payoff
- Life goes on - start paying in 60 days!
- Remember 180 day rule
- Remember flexible payment options already in place with or without consolidation

The Numbers

- Growing volume
- Default, and effect on cohort default
- What we are watching

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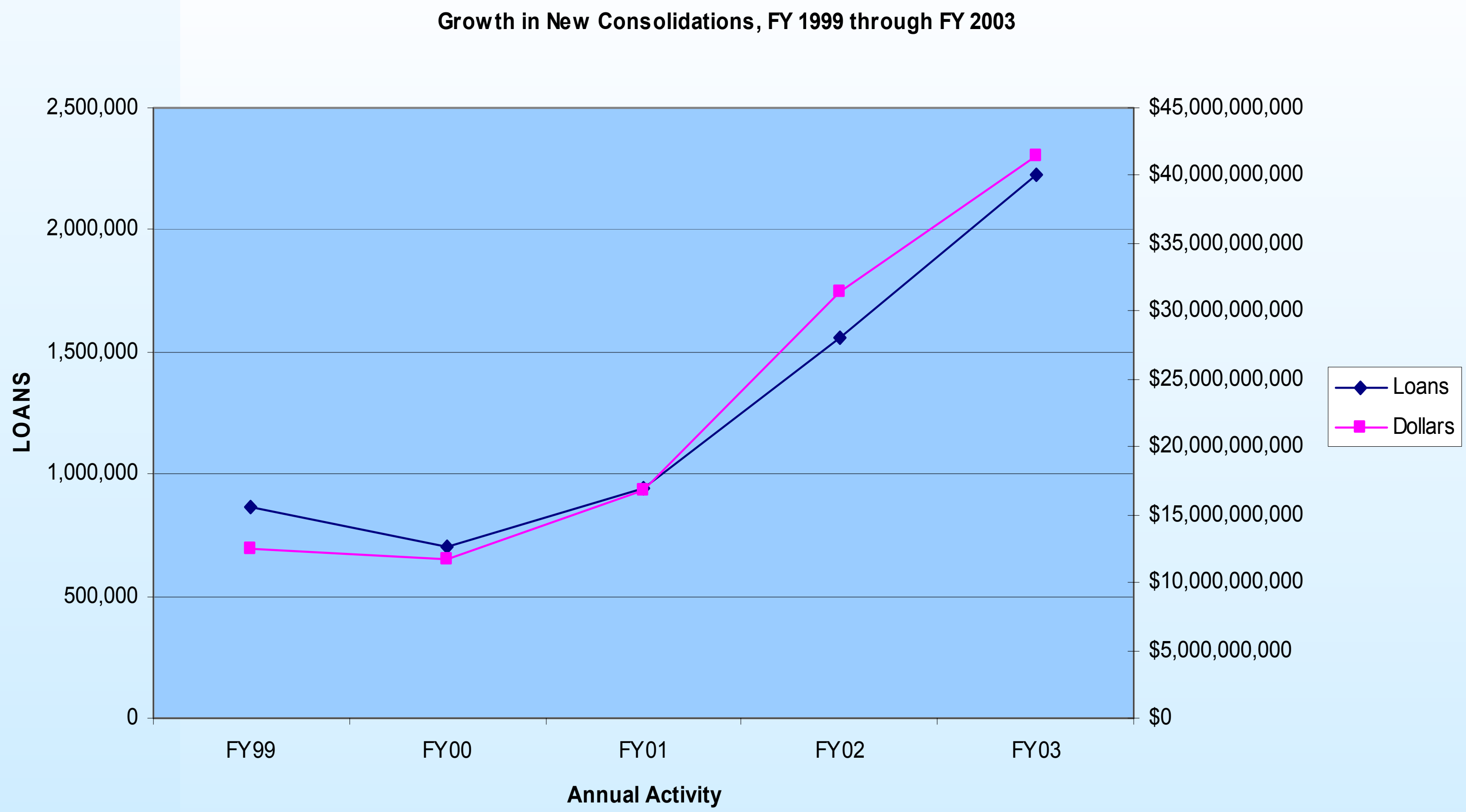
New Volume FY1999-2003



Default, and effect on Cohort Default

- No evidence of higher incidence of default for consolidation loans

Effect on cohort default

- Loans consolidated during in-school and in grace have never "entered repayment" and therefore are never counted in cohort definition
- Underlying loans in repayment at time of consolidation counted as default in CDR calculation if consolidation loan defaults during cohort period

What are we watching

- What are we watching

  --Increase in consolidation and effect on lifetime default rate

  --Unnecessary confusion

  --Changes resulting from the Reauthorization of the Higher Education Act and/or FY05 Appropriations

Take Away

It's the basic questions:

- **WHAT?**

  What is the deal (really)? Do the math….

- **WHO?**

  Who is the lender (really)?

Take Away

- Goal is to ensure successful repayment
- Consolidation of student loan obligations could be an effective debt management tool
  -- Fixed vs. variable
  -- Spread out payment/but pay more interest
  -- Importance of loss of benefits on underlying loan; benefit gained with consolidation loan
- Consider rehabilitation vs. consolidation for defaulted borrower

Need More?

- Questions and Answers
- www.mapping-your-future.org (FFEL)
- www.loanconsolidation.ed.gov (DL)
- Contact:

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