

Questions You Should Answer About Federal Consolidation Loans Before July 1, 2006

Borrowers with eligible federal student loans should consider consolidating their loans by applying for a Federal Consolidation Loan before July 1, 2006. Here are answers to some important questions dealing with federal loan consolidation that can help you decide the appropriate course of action.

Q.1 Why should I consolidate my eligible federal student loans?

A.1 There are a number of reasons why you should consider consolidating your eligible federal student loans, including:

- **Lower monthly loan payments**

Payments typically will be lower each month because you usually are eligible for a longer repayment period with a Federal Consolidation Loan (FCL). Increasing the repayment period reduces the minimum monthly loan payment you are required to pay, but will increase the total amount of interest you'll pay over the life of loan repayment.

- **Single-statement billing for your federal student loans**

If you currently have multiple federal student loans that are held by multiple loan holders/lenders, you can pay off all eligible loans by borrowing a single Federal Consolidation Loan (FCL). The FCL will be held by a single loan holder/lender and you will have single-statement billing for your federal student loan debt.

- **Fixed interest rate**

Federal Consolidation Loans have a fixed interest rate. Consolidating your variable rate Federal Stafford/Federal Direct Loans allows you to fix the interest rate on this federal student loan debt for the life of loan repayment.

Q.2 Why should I apply for a Federal Consolidation Loan before July 1, 2006?

A.2 There are several reasons that may be of interest to you:

- Interest rates on your current Federal Stafford Loans are variable, and will likely rise again this year on July 1, 2006. The current upward trend in the 91-day Treasury bill suggests that rates will be higher when the rate is reset on July 1.
- And if you'll still be in school on or after July 1, 2006, this will be the last time that you can consolidate your eligible federal student loans that have an in-school status.

Beginning July 1, 2006, students will no longer be able to put their Federal Stafford Loans into early repayment so that they can be consolidated at the current interest rate while still in school.

So it's important that you consider applying for a Federal Consolidation Loan and submitting the application to your lender so that the lender receives it before July 1, 2006. Be aware, however, that once you consolidate your variable rate Federal Stafford/Federal Direct Loans, you will not be able to take advantage of any future interest rate changes in those loans.

Q.3 What are my options if I want to consolidate the Federal Stafford/Federal Direct Loans I have borrowed this past year, but already have at least one Federal Consolidation Loan (FCL)?

A.3 There are three options:

- **Option A** – You can add your new, fully disbursed federal student loans to an existing FCL within 180 days of the date the existing FCL was funded.
- **Option B** – You can borrow an additional FCL to consolidate your new, fully disbursed federal student loans, and retain your existing FCL as a separate loan.
- **Option C** – You can borrow a new FCL and consolidate both your new, fully disbursed federal student loans and your existing FCL together into a new, single Federal Consolidation Loan.

Q.4 Which of the above options is best if I will still be in school on or after July 1, 2006?

A.4 That depends on what's most important to you, the **in-school borrower**.

- **Convenience** – Option A or C will provide you with one Federal Consolidation Loan, and therefore, one loan servicer, one monthly billing statement, and one monthly loan payment once you have to start making payments. This will make loan repayment more convenient and easier to manage.
- **Retaining the grace period** – You should not consolidate your newly disbursed federal student loans if you want to retain the grace period on them once you graduate or drop below half-time enrollment status in your program of study. Consolidating them would require that you first put those loans into early repayment and waive their grace period.

Note that you may still be able to postpone loan repayment even without a grace period on your Federal Consolidation Loan(s) once you graduate or drop below half-time enrollment status. If you qualify for a deferment or forbearance, you could temporarily postpone repayment, or reduce the amount of your monthly loan payment.

- **Maximum repayment period** – Option A or C maximizes the amount of federal student loan debt you are consolidating. This allows you to qualify for the longest repayment period permitted based on the amount of your debt. Remember, the longer the repayment period, the smaller your monthly loan payment for any given level of debt. The longer the repayment period, however, the more interest you will pay over the life of loan repayment.
- **Ability to target loan prepayments** – Option B allows you to target prepayments at debt with the highest interest rate and therefore the greatest interest savings. Suppose you currently have a Federal Consolidation Loan with a fixed interest rate of 2.875% and you have new, fully disbursed federal student loans that you want to consolidate, but these loans currently have a variable interest rate of 4.7%. If you consolidate these new loans in a separate, second FCL (i.e., you do not include your existing FCL as one of the loans you are consolidating), the weighted average for your second FCL will be 4.7%, and when rounded up to the nearest one-eighth percent, your fixed interest rate for this FCL will be 4.75%. If you make a loan prepayment, you can apply it directly to this second FCL that has the higher fixed interest rate. Had you combined all the loans together, the new fixed interest rate would have been somewhere in-between the interest rate of your existing FCL (2.875%) and the 4.7% interest rate of the new loans you consolidated. If you were to make prepayments on this combined FCL, you would only capture interest savings at this “in-between” rate.
- **Least cost** – Option B minimizes the frequency of interest capitalization on your existing Federal Consolidation Loan (FCL) and this results in less “interest paid on interest” in the long run. While your FCL is in an approved deferment or forbearance period, interest is accruing as simple interest. In other words, it is only accruing on the principal balance of your FCL at the time the deferment or forbearance began. That accrued interest will not be added to the principal balance of your FCL until the period of deferment or forbearance ends, or if that FCL is paid off (such as with a new FCL). If you do pay it off with a new FCL, then you now are accruing interest on the original FCL principal plus all of its accrued interest. This increases the cost of the loan in the long run.

Q.5 Which of the above options is best if I am graduating before July 1, 2006?

A.5 That depends on what's most important to you, the **graduating borrower**.

- **Convenience** – Option A or C will provide you with one Federal Consolidation Loan, and therefore, one loan servicer, one monthly billing statement, and one monthly loan payment. This will make loan repayment more convenient and easier to manage.
- **Retaining the grace period** – Option B or C would allow you to retain the grace period on your new, fully-disbursed federal students loans before they are consolidated. And, the pre-July 1, 2006, interest rate still could be used to calculate the weighted average for your Federal Consolidation Loan (FCL) interest rate as long as your FCL

application is received by your lender prior to July 1, 2006. To retain your grace period for the new, fully disbursed federal student loans, you simply need to provide your Federal Stafford/Federal Direct Loan grace period end date on your new FCL application. If you do, your lender will not complete the processing of your application and the funding of your FCL until near the end of that grace period.

This is one reason why it is better not to use Option A to consolidate any new, fully disbursed federal student loans. Adding these loans to an existing FCL within 180 days after the original FCL is made negates your ability to benefit from the grace period hold feature.

- **Maximum repayment period** – Option A or C maximizes the amount of federal student loan debt you are consolidating. This allows you to qualify for the longest repayment period permitted based on the amount of your debt. Remember, the longer the repayment period, the smaller your monthly loan payment for any given level of debt. The longer the repayment period, however, the more interest you will pay over the life of loan repayment.
- **Ability to target loan prepayments** – Option B allows you to target prepayments at debt with the highest interest rate and therefore the greatest interest savings. Suppose you currently have a Federal Consolidation Loan with a fixed interest rate of 2.875% and you have new, fully disbursed federal student loans that you want to consolidate, but these loans currently have a variable interest rate of 4.7%. If you consolidate these new loans in a separate, second FCL (i.e., you do not include your existing FCL as one of the loans you are consolidating), the weighted average for your second FCL will be 4.7%, and when rounded up to the nearest one-eighth percent, your fixed interest rate for this FCL will be 4.75%. If you make a loan prepayment, you can apply it directly to this second FCL that has the higher fixed interest rate. Had you combined all the loans together, the new fixed interest rate would have been somewhere in-between the interest rate of your existing FCL (2.875%) and the 4.7% interest rate of the new loans you consolidated. If you were to make prepayments on this combined FCL, you would only capture interest savings at this “in-between” rate.
- **Least cost** – There is very little difference in cost among the three options (A, B, and C) if the length of the repayment period is the same, and if you're not planning to make prepayments. This is further explained and illustrated with the answer to the next question (Q.6).

Q.6 Why is there little cost difference between keeping my Federal Consolidation Loans (FCL) separate versus combining them into a single FCL?

A.6 The fixed interest rate for a Federal Consolidation Loan is calculated as the weighted average of the interest rates of the loans being consolidated, rounded up to the nearest one-eighth of one percent, not to exceed 8.25 percent. Thus, the interest rates of the loans you are consolidating will impact the final interest rate for your FCL in proportion to the

amount of each loan being consolidated. Said another way, due to the mathematics of weighted averages, although the ultimate fixed interest rate may be different with each option, the total amount paid each month and the total amount repaid over the life of loan repayment will be essentially the same as long as the repayment period is the same length for each loan.

Any difference in interest expense between combining both your new, fully disbursed federal student loans with your existing FCL (Option A or C), and borrowing a separate FCL for your new loans (Option B), will be due to the differences in the amount of rounding that takes place when the weighted average of the interest rates is rounded up to the nearest one-eighth of one percent in each option, and/or in the amount of any accrued interest that gets capitalized before the new consolidation takes place.

Here are two scenarios to illustrate this explanation

Scenario #1

Graduating borrower has the following loan balances:

- \$37,000 Federal Consolidation Loan (FCL) borrowed while in school
- \$18,500 new, fully disbursed eligible federal student loans

Options	Loan Amounts	Interest Rate	Monthly Payment	Total Payout
B	FCL #1= \$37,000	2.875%	\$173.06	\$51,918.63
	FCL #2 = \$18,500	4.750%	\$105.47	\$31,641.51
	TOTALS		\$278.53	\$83,560.14
	Loan Amount	Interest Rate	Monthly Payment	Total Payout
A/C	\$55,500	3.375%	\$277.85	\$83,353.82

With all three options, the borrower is eligible for a maximum repayment period of 25 years. In order to get the 25-year repayment period for both FCL #1 and FCL #2 in Option B, the borrower must select the Extended Repayment Plan for each FCL. The Extended Repayment Plan has a standard repayment period of 25 years. Without the Extended Repayment Plan, the repayment period for FCL #1 and FCL #2 as separate loans would not exceed 20 years.

To qualify for the Extended Repayment Plan, the borrower must have more than \$30,000 in Federal Family Education Loan Program (FFELP) debt and not have FFELP debt that was borrowed prior to October 7, 1998. This borrower would qualify for the Extended Repayment Plan because at the time he or she borrowed FCL #1, the debt was greater than \$30,000, and it is assumed here that the borrower had no debt that was borrowed prior to October 7, 1998. With FCL #2, the borrower's total FFELP debt is \$55,500 (FCL #1 equals \$37,000 and FCL #2 equals \$18,500, the sum of which is \$55,500).

With Options A and C, the borrower is eligible for a 25-year repayment period on the Federal Consolidation Loan because the sum of the borrower's eligible debt is \$55,000.

In Option B, the interest rates, monthly payments, and total payout are based on having two Federal Consolidation Loans (FCL)—the original FCL and a second FCL for the new, fully disbursed federal student loans. In Option A/C, the interest rate and payments are based on the combining of all loans into a single Federal Consolidation Loan. As shown above, either Option A or Option C would be the least-cost option. They would save the borrower \$0.68 per month, and \$206.32 over the 25 years of repayment, in contrast to what would be paid in Option B. The opposite is true in Scenario #2.

Scenario #2

Borrower has the following loan balances:

- \$115,500 Federal Consolidation Loan (FCL) borrowed while in school
- \$38,500 new, fully-disbursed eligible federal student loans

Options	Loan Amounts	Interest Rate	Monthly Payment	Total Payout
B	FCL #1 = \$115,500	2.875%	\$479.20	\$172,512.29
	FCL #2 = \$38,500	4.750%	\$200.83	\$72,300.32
	TOTALS		\$680.03	\$244,812.61
	Loan Amount	Interest Rate	Monthly Payment	Total Payout
A/C	\$154,000	3.375%	\$680.83	\$245,098.14

With all three options, the loans are eligible for a 30 year repayment period because the sum of the borrower's total eligible debt exceeds \$60,000.

As shown above, Option B would be the least-cost option. It would save the borrower \$0.80 per month, and \$285.53 over the 30 years of repayment, in contrast to what would be paid in either Option A or Option C.

Q.7 Should I consolidate my Federal Perkins Loans?

A.7 Probably not. Since the Federal Perkins Loan already has a fixed interest rate of 5.0 percent, there is no benefit gained from the fixed interest rate structure of the Federal Consolidation Loan (FCL). Furthermore, if you consolidate your Federal Perkins Loan, the interest subsidy on those loans would be lost during any approved deferment period on the resulting FCL. In addition, there are a number of loan cancellation/discharge benefits related to service and employment that would be lost if the Federal Perkins Loan is consolidated.

Q.8 How do I apply for a Federal Consolidation Loan from Access Group?

A.8 Visit *FederalConsolidation.Org* or call us at 866-241-5769.

Q.9 Where can I get more answers to questions about Federal Consolidation Loans?

A.9 In addition to the online application, *FederalConsolidation.Org* also provides answers to additional frequently asked questions, updates about the Federal Consolidation Loan program, interactive payment and incentive calculators, and more. And, to understand the basics of federal loan consolidation, visit the WiseBorrower online educational tutorial on Federal Consolidation Loans at *accessgroup.org/wiseborrower*.