Fast Facts About Consolidation

Final Spring 2003 Edition

1. **Eligible Loans** - Consolidation is for FEDERAL student loans. Eligible loan types include Federal Stafford (Subsidized and Unsubsidized), Federal Perkins and Federal SLS Loans. Your eligible loans that you choose to consolidate will be combined on one new promissory note with a fixed interest rate calculated as a weighted average of the consolidated loans' interest rates.

2. **Types of Consolidation** - There are two ways to consolidate; with the federal Department of Education's Direct Loan Program or with a Federal Stafford Lender, e.g. Access Group or Total Higher Education (T.H.E.).

3. **Benefits of Consolidation** – During this time of historically low interest rates, almost all borrowers will receive a benefit from consolidation. The notable exception is the rare borrower that plans to repay the loans in less than one year (before interest rates will change again). Benefits of consolidation include:
   - The opportunity to lock-in a low interest rate for the life of the loan.
   - Significantly lower required monthly payment for the loans.
   - Lower payments for federal loans could allow the borrower to prepay higher cost commercial loans and credit cards more quickly.

4. **Possible Costs of Consolidation** – Although consolidation at the favorable rates currently in existence will save borrowers money, there are some costs.
   - Consolidation allows the loans to be paid over a longer period of time. This can result in a higher total amount of interest paid if the borrower extends repayment.
   - Consolidation may start your repayment slightly earlier than would otherwise occur resulting a loss of 1-2 months of interest free grace period on the ***subsidized*** portion of the Federal Stafford Loans. (approx. $40 per month per $8500 loan) If needed, you can request a deferment or forbearance from your consolidation lender to delay repayment.
   - It is possible that interest rates could go lower and you would be able to fix an even lower rate. The current rates, however, represent historic lows.

5. **Timing** – With consolidation, timing is everything. The new interest rates go into effect on July 1, 2003. Before you consolidate, remember the following timing guidelines:
   - **Too Early** – You do not want to start your consolidation before July 1, 2003. Based on current interest rates, you could end up paying an interest rate that is .6% higher than if you wait. (A $2,000 mistake for the average borrower.)
   - **Too Late** – On the other hand if you do not consolidate during your grace period (the six months following your graduation May 13, 2003- November 13, 2003) the interest rate on your loans will increase by .6%. (A $2,000 mistake.)
   - **Just Right** – It can take from 45-60 days for your consolidation to be completed. With this in mind, you should start the consolidation process no earlier than July 1 and no later than September 13, 2003. If you wait until September 13, you will utilize more of your interest-free grace period on your Subsidized Stafford Loans and your consolidation will complete at nearly the same time that your repayment would have naturally begun.

6. **Selecting a Consolidation Lender** – If you have federal student loans with more than one lender, you can use any consolidation lender, otherwise, you must use your current lender. **WARNING**: Be careful with lenders that use telemarketers and direct mail. Consider their terms carefully and ***we urge you not to respond*** to their sales tactics. The phone representatives are often on commission and will receive a benefit with a hasty decision. In addition, the Financial Aid Office has a greater ability to assist you if you encounter difficulty when using the lender that you used while attending GULC. Several reputable lenders are listed below. If you have any questions regarding a specific consolidation lender, please contact the Financial Aid Office.
   - Access Group - (800) 282-1550, www.accessgroup.org
   - Total Higher Education - (888) 843-3095, www.northstar.org
   - Student Loan XPress - (866) 311-8059, www.mycaploan.com/slx08
   - U.S. Dept. of Ed. Direct Loan Program - (800) 557-7392, www.loanconsolidation.ed.gov

7. **Interest Savings** – A variety of consolidation programs are available, each with slightly different incentives. For comparison purposes, we assume that borrowers fix their interest rate with consolidation and repay their loans in the original 10 year repayment plan. The approximate interest savings (versus 10-year historic interest rates) per $10,000 of loan principal would be:
   - $2,458 without utilizing any special repayment incentives.
   - $2,592 using the .25% interest rate reduction for automatic payment / direct debit from your checking or savings account.
   - $2,803 using ***Access Group's*** direct debit savings and 1% interest rate reduction after 48 months of on-time payment.
   - $2,865 using ***Total Higher Education's*** (T.H.E.) bonus program (an annualized .75% principal reduction) for consolidation loans that are paid in a timely manner.
   - $2,899 using ***Student Loan XPress'*** direct debit savings and 1% interest rate reduction after 33 months of on-time payment.

8. **Comparing the Savings** – The above savings assume that everything goes as planned. Based on anecdotal evidence, only about 10% of students make it through the longer on-time payment incentive windows (33-48 months). Even one late payment can result in the loss of eligibility for the bonus interest rate reductions. If you are looking for a "sure thing", then ***T.H.E.'s*** program may be the one for you because you do not have to make any payments before the benefits kick in. Regardless of the lender you choose, Consolidation can save you money vs. historical rates.

9. **Consolidation Procedure** – The consolidation process is relatively simple and most lenders require that you complete the following basic steps:
   - Select your Consolidation lender and contact them by telephone or web. You will provide the approximate balance and servicing information for your current loans.
   - You will sign and return a completed promissory note to your consolidation lender.
   - Your consolidation lender will "purchase" your federal loans from your current lender and send you information when the process is complete.
   - You will be required to start repayment within 30 days of the completion of the consolidation process.
   - If you do not know which lender holds your federal loans, you may access the National Student Loan Database at: www.nslds.ed.gov

If you have questions, please contact the GULC Financial Aid Office at 202-662-9210

Advanced Facts About Consolidation

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This section addresses concepts that go beyond the basic issues surrounding consolidation. **This information is not offered as financial advice, may not be applicable for all graduates and should be used only as a basis for your own investigation of financial options appropriate for you.** In general, as long as you are doing something financially "smart" with your consolidation savings, i.e. not taking lavish vacations, you will probably come out ahead. Consult with a financial planner and/or tax advisor if you have questions pertaining to your specific circumstances.

1. **<u>The Length of Consolidation Repayment</u>** – All of the calculations above were completed using a 10-year repayment term in order to make "apples to apples" comparisons. At this time of historic low interest rates, it is advisable to determine if there are alternatives that would save you money. For example, most graduates would be able to consolidate their loans for up to 30 years (LRAP participants should follow the LRAP 15-year guideline). A longer consolidation repayment would offer the following benefits from the lower required payment:
   - A larger payment may be made to other more expensive types of debt (e.g. commercial loans, credit cards, etc.)
   - A larger contribution may be made to your retirement plan(s)
   - Savings may be increased to provide for a down payment on a home.

2. **<u>Inflation's Helping Hand</u>** – With a consolidation interest rate in the 2.875% range, your actual annual cost for the loan approaches zero. How this works:
   - You consolidate your loan for 2.875% with a 30-year repayment.
   - You select T.H.E. as your consolidation loan provider. T.H.E. offers a .75% bonus to borrowers in repayment and not delinquent. Your new effective rate is approximately 2.125% (2.875% less .75% T.H.E. bonus).
   - Inflation historically averages approximately 3%, so to have $10000 of spending power next year you will have to have $10300.
   - Your loan will be accruing interest at roughly 2%, so $10000 in debt will be $10212 next year. Since your interest costs are slightly less than inflation, the annual cost in real financial terms over a long period approaches (and possibly falls below) zero.

3. **<u>Better than a Mortgage?</u>** – Assume the same scenario as above with a consolidation loan @ 3.5% with a .75% repayment bonus giving an effective rate of approximately 2.75%. As of 6/5/03, the average 30 fixed mortgage interest rate was approximately 5.0%. Taking the tax savings from a mortgage into account, which is the better financial deal and which loan should you prepay?

<u>EXAMPLE</u>:

Mortgage Interest Rate	5.0%
Federal Tax Savings (30% rate)	-1.5%
State Tax Savings (7% rate)	<u>-0.35%</u>
Effective Mortgage Interest Rate	**3.15%**

Comparing the effective interest rate of the 30 year fixed rate mortgage (3.15%) against the effective rate of the 30-year fixed rate consolidation loan, (2.125%), in this example, the consolidation loan is a better deal. As an added feature, unlike mortgages, your consolidation loan has payment deferment and forbearance options (unemployment, hardships, in-school) and is forgivable upon death or total and permanent disability, so you do not have to pay for insurance.

4. **Should Perkins Loans and/or Undergraduate Federal Loans be Consolidated?** – The interest rate on the consolidated loan is determined by taking the weighted average of the interest rates of the loans to be consolidated. If you add in loans with higher interest rates, the entire consolidation loan may become more expensive. Ask yourself the following questions:
   - **Do I want the convenience of fewer payments even if the loan is more expensive?** If yes, then consolidation of all of your federal loans may be the right answer.
   - **Do I want to have prepayment targets (i.e. loans that are more expensive that I can prepay with my savings from my lower cost consolidation loan)?** If yes, then consolidating your loans together in one large loan may not be the answer.

     EXAMPLE:

     Jane's Federal Perkins Loans ($12,000) are at 5.0% and her GULC federal Stafford Loans ($55,500) are at 2.82% and she has GULC commercial loans as well. Her GULC Stafford Loan consolidation interest rate is 2.875% (rounded to the next highest 1/8th percent) and if she includes the Perkins Loans, the combined interest rate is 3.25%. Although if both loans are extended to 30 year repayment, the total interest paid is almost the same, Jane decides not to consolidate the Perkins and Stafford Loans together. This gives her two prepayment targets. First, she can direct her prepayments to her GULC commercial loans until those loans are repaid. Second, she can direct her prepayments to her higher cost Perkins Loans. This way, Jane will eliminate her highest cost loans first and save the most money.

   To determine the effect of your prior and/or federal Perkins Loans on the consolidation interest rate for your loans, first contact your lender to determine the interest rate and outstanding balance on your non-GULC loan(s). Once you have the applicable interest rates, you can visit T.H.E.'s consolidation calculator: www.northstar.org/Consolidation/Consolidation_Calc.aspx. Graduates may not want to consolidate Federal Perkins Loans if a career in law enforcement or direct service to low income children is planned. The federal Perkins Loan has forgiveness provisions that will be lost if the loan is consolidated.

5. **Consolidation Prepayment vs. Retirement Investing** - If you have the opportunity to contribute to a retirement plan with your employer, your consolidation loan may allow you some additional dollars in your budget to direct to your retirement savings. In the following example, we assume the same numbers as above (2.875% consolidation with a .75% bonus on a $55,000 balance) and a relatively conservative retirement account return of 7%.

10 year repayment monthly payment	$514	total interest	$6,170
30 year repayment monthly payment	$209	total interest	$19,655
		Increased interest cost	$13,485

   If you take the $305 per month for ten years and invest it in your tax-deferred retirement account at 7% annual return, your retirement account would contain $113,107 in 30 years! Not bad for only $13,485 in increased interest costs.