

Office for Financial Success – Financial Tip of the Week

A service of the Personal Financial Planning Department
College of Human Environmental Sciences
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FEDERAL STUDENT LOAN CONSOLIDATION

As the end of the semester nears, it seems timely to review the issue of student loan consolidation. This week I'll address consolidation of federal loans and will address consolidation of private loans in a separate tip.

A reminder about recent legislative changes (7/1/06):

- In-school consolidation is no longer an option. You will need to be out of school to be eligible to consolidate.
- You are no longer required to have multiple lenders. You can consolidate with whomever you choose even if you only have one lender. Shop for the best deal for you!
- You are no longer able to consolidate your loans with your spouses' loans. Not a smart idea, but is no longer an option.

Important consolidation considerations:

- If you have specific loans (i.e., Perkins) that may be forgiven or repaid by your employer, state, etc. Find out if they will repay/forgive federal loans in general (ok to consolidate if that is the case) or if they will repay/forgive that specific loan (in which case you don't want to consolidate it)
- If a potential lender offers to combine your federal loans with private loans, credit cards, or any other non-federal student loan debt, RUN!
- You can AND SHOULD reconsolidate even if you have already consolidated to lock in the low rates in prior years (4.7% last year; 2.77% prior year, 2.82% before that). It will be necessary in order to "move" the loans to a lender that will offer you the best borrower benefits. Since your rate is a calculated "weighted average," doing so will not have a negative impact on your rate.
- Some people are afraid to consolidate because their repayment will be extended (obviously resulting in more interest paid over the life of the loan). Keep in mind that you can select a short repayment time when you consolidate – you can also choose to pay whatever monthly amount you want (NO LEGITIMATE PROGRAM will assess a penalty for you paying off the loan early).

With all of the offers I get, how do I decide where to consolidate?

The first point I want to make here is that a federal consolidation loan is a federal consolidation loan – in other words, your ability to defer your loans [or other governmentally 'set' terms of the loan] will be the same regardless of who your lender is. Many people consolidate with the government because they assume they will have more 'benefits' than other programs. The reality is that the benefits of the loan will be the same regardless of who the loan is through. What then is the difference? The financial benefits companies offer – ultimately, that is the "bottom line" and the only meaningful difference between consolidation programs.

My experience with student loan consolidation over the past several years has drawn me to one primary conclusion – the "financially smart" option is not going to be the same for each student. It is largely a factor of how you plan to repay your debt. Let me offer up some examples. An average consolidation program will offer interest rate reductions for automatic payment and for paying on time (typically for 3 or 4 years) – for most,

these will total 1.25% (.25% for auto payments; 1% for 36-48 on-time payments). Interest rate reduction benefits are great if I'm in a situation (because of the low rate I've consolidated at and/or my financial goals, my starting salary, or other potential factors) where I am interested in extending the repayment of my debt (more than 8 years in the scenario I will illustrate below). My ability to extend my debt will be based upon the amount I borrow, but I can potentially extend the debt anywhere from 12 years to as many as 30. Obviously if I plan to pay the debt back in a couple years, this type of program isn't very beneficial because the only benefit I will get is the .25% for auto pay. Thus, if this is my objective, I should seek out a company that instead of an interest rate incentive, their benefits are 'principal balance' credits. These are normally advertised as "consolidate with us and receive as much as \$2,000 cash back!" I've seen more than one professional student where they would save over \$100,000 in interest over the life of the loan repayment because of the interest rate reductions. Obviously wouldn't make much sense for them to get excited to consolidate to get a \$2,000 benefit ...

Below, I have provided examples of the best borrower benefit programs I have currently seen for each different repayment scenario. There are some points, however that I want to emphasize as you make personal considerations:

- (1) These are general guidelines/rules of thumb - run the numbers to see what makes the most sense for you. Do your own homework - use these resources as guidelines as you try to find better options [which if you do, make sure to let me know].
- (2) Read the applications for any caveats. For example, the Key Bank credit (quick repayment example below) is foregone if you defer or forebear the loans during the first 3 months of repayment. The Educational Loan Company programs require you to have a minimum loan amount (\$30,000 in the extended repayment program; \$15,000 in the intermediate program example). So read through the details to make sure the program will fit with your situation.
- (3) Be smart. Take a few minutes to figure things out. There's a lot of dollars on the table for most students. It's worth your time to talk to someone about things. Consider all options - most states offer consolidation programs. I list North Carolina because it has the best benefits with limited restrictions. Some states have more restrictions, some have none. If you went to school or lived somewhere else, take a look at their program to see what type of benefits their program offers.

QUICK REPAYMENT (1-3 years)		
Key Bank	.25% interest rate reduction for auto pay	5% principal balance credit
FinanSure	.25% interest rate reduction for auto pay	4.5% principal balance credit

EXTENDED REPAYMENT (8+ years)		
Educational Loan Co.	.25% reduction for auto pay	2.25% reduction after 48 on-time payments
The Loanster	.25% reduction for auto pay	2% reduction after 36 on-time payments
North Carolina	.25% reduction for auto pay	2% reduction after 48 on-time payments

INTERMEDIATE REPAYMENT (3-8 years)		
Educational Loan Co.	.50% reduction for auto pay	1.25% reduction after 48 on-time payments

*FYI - The Department of Ed (Direct Loan consolidation program) offers a .25% reduction for auto pay. The MOHELA consolidation program offers similar benefits (.25%).

SimpleTuition.com

While at a conference last month in Illinois, I ran across a great resource for evaluating consolidation offers that I'd like to share. It provides an unbiased way to compare consolidation options from any lender. All you need to do is enter your federal student loan information, then compare and sort the options that are customized for you. If the program you're considering isn't listed, you can enter the details of the program and it will help you evaluate it. You can sort by such items as monthly payment, total loan cost, loan term, APR. You can then conduct side-by-side comparisons with the companies that you narrow your decision down to ... pretty nifty [and free].

I'm currently working with Simple Tuition to get a Mizzou-tailored resource - it's currently in a demo stage, but I've requested that they provide information about North Carolina, Educational Loan, and other companies that provide better benefits than others but aren't available on their main site (<http://www.simpletuition.com>). The demo site is: <http://demo.simpletuition.com/missouri>. As it is a work in progress, I would be interested in your feedback about the site, usability, other consolidation programs that should be included, etc.

Consolidation Resources.

The OFS website (<http://financialsuccess.missouri.edu>) offers numerous consolidation resources. Calculating your weighted rate average [if you have consolidated in the past or have loans (i.e., Perkins) with different rates]; calculating your loan payment; consolidation strategies; repayment options; information about state consolidation programs, etc. Simply click on the 'student issues' button.