Benefits of Consolidation

There are many benefits to student loan consolidation. When a borrower consolidates student loans, he or she locks in the current, low interest rate, eliminating the need to worry about how interest rates will skyrocket in the future.

In many cases, consolidation lenders will have a borrower-benefit program, which often means an additional 1.25 percent interest rate reduction for qualified borrowers. Depending on the lender, these programs can often reduce interest rates to as low as 5.375 percent.

By locking in low rates for the life of their loan, borrowers enjoy the benefits of reduced monthly payments of almost 50 percent, which in the long run, will improve credit scores and potentially save borrowers thousands of dollars over the life of their loans.

Additionally, consolidation simplifies a borrower's finances. No longer does one have to rummage through piles of confusing loan documents from multiple lenders. Each month, a borrower with consolidated loans will receive just one bill from one lender.

Also, there are no penalties for early repayment. This gives you the option to pay off debts quicker, which will save you the headache of being in debt and the need to pay additional interest fees towards the end of your loan.

Improve Your Credit Score

As you may well know, credit scores play a major role in determining whether or not you get an apartment, house, car, cellular phone - the list goes on indefinitely. It's your way of showing companies that you are trustworthy and reliable enough to make consistent and timely payments on acquisitions that are more expensive. Having a bad credit score taints you, jeopardizing your chances of being approved by creditors.

Credit scores are negatively affected by late payments, incomplete or partial payments, defaults, and judgments and liens. The score can be broken down into several components: 35 percent of your score depends on your payment history; 30 percent, on your outstanding debt; 15 percent, the length of your credit history; 10 percent, recent inquiries on your credit report; and 10 percent, the types of credit your currently use.

Because a student loan is money owed, it adversely affects your payment history and your outstanding debt, which comprises 65 percent of your total credit score. This, of course, may be debilitating to your good credit.

Continued on back

Stafford loans, which are the most common type of student loans, are often issued in subsidized and unsubsidized portions. A student could graduate with as many as four subsidized Stafford loans and four unsubsidized Stafford Loans, totaling eight separate loans. Furthermore, most students don't make payments on their loans until after they graduate.

In summation, students may have eight loans in four years without a single payment.

Obviously, there are extenuating circumstances, including, "How can a student be expected to pay off their debts? They're concentrating on schoolwork! How can a full-time student work full-time?" Lenders recognize this and often offer grace periods, which exempt students from repayment for a few months after graduation.

Unfortunately, computers are responsible for calculating credit reports. For calculating machines, numbers are numbers, regardless of how compelling your story may be. Eight loans, four years, and no payments make a horrible combination.

A lesser-known benefit of consolidation is the fact that it improves your credit score. When you consolidate, your new lender pays off all of your eight loans, and then opens up one new consolidation loan. When a computer calculates your credit score, they will see this: eight loans paid in full. You will look like a responsible and trustworthy borrower.

Consolidation increases your credit score because it pays off all your old loans and reduces your number of open accounts.

Explaining the Consolidation Process

Although the student loan consolidation process seems complicated, it's actually quite simple. We've broken down the process into five easy steps to show you that there are no hidden tricks and messy loopholes.

Apply. After deciding which consolidation company has the best offers, you will need to fill out a consolidation application. Don't worry. Most lenders have student loan consolidation specialists with whom you can confer about your overall savings and the repayment plan that will best fit your financial circumstance.

Application is easy and free with no obligations. Many companies will send potential clients an application packet that includes the consolidation application, applicable discounts, and methods to compute your interest rates. Some, such as Law School Loans, allow students to apply over the Internet using an E-Signature process.

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Once the lender receives your signed application, they will review your application, checking to make sure that your case complies with the Higher Education Act. If it does, they will proceed with the consolidation process.

Loan Verification Certificate. After lenders review the accuracy of your consolidation application, they will send your existing loan holder a loan verification certificate, which is essentially a payoff statement. The LVC reveals how much the student owes to that particular lender.

The original loan holder often takes a long time - sometimes even up to two months - to return the LVC to the consolidation company because they don't want to relinquish one of their borrowers and their interest payments.

If your original loan holder hoards a student's loan information, they stall that student's consolidation process. This may jeopardize the student's chances of locking in the current variable low interest rate. In two months' time, the variable interest rate might increase, making you lose thousands of dollars in savings. That is why many consolidation companies stress the importance of timeliness.

It should also be mentioned that while your application is pending, you ought to continue making payments on your existing loans. Because your loans are not yet paid off, you may incur late payments and negatively affect your credit score.

Paying Off Old Loans; Starting Anew. When the consolidation company receives the student's loan information, they will cut a check to all previous lenders, paying off each loan in full. Your consolidation lending company now owns all your loans, so you will only have to make one low monthly payment.

The consolidation company will then create a new federal consolidation loan for you. By this time, you will have successfully combined all your loans. Even better, the consolidation company will have paid off all other lenders, which will bolster your credit score by reducing the number of loans and showing that you have paid off previous debts.

Calculating the Interest Rates

LIBOR Index

LIBOR, also known as the London Interbank Offered Rate, is the interest rate at which banks borrow money from other banks in the London Interbank Market. It is also the standard financial index used in U.S. capital markets.

Because London's euro-based market reflects the world's economic condition, international investors use the LIBOR interest rate to match the cost of lending to the cost of funds. Many adjustable rate financial instruments such as Adjustable Rate Mortgages (ARMS) and other variable-rate loans base their interest rate on the LIBOR Index. It is the basis for some of the world's most active interest rate markets.

Continued on back

The LIBOR Index is set by the independent organization, the British Bankers Association (BBA), and is an average of inter-bank deposit rates offered by selected London banks for maturities. These rates are applicable to the U.S. dollar, the U.K. pound, the Swiss franc, the Canadian dollar, the Japanese yen, and the Danish krone. In a single month, the BBA fixes hundreds of LIBOR rates in different currencies.

These rates are compiled each working day by an electronic vendor and are then broadcast by various international distribution networks. The LIBOR Index, often used to set loan interest rates in the U.S., is posted monthly on Fannie Mae's website and daily in the Wall Street Journal.

Prime Rate

One of the most desirable interest rates is called the prime rate. Banks offer prime rate to their most creditworthy customers. Unlike the LIBOR Index, the prime rate does not adjust on a regular basis. However, when the prime rate does adjust, the LIBOR Index generally has smaller changes than the prime rate.

The Wall Street Journal Prime Rate is the most standard prime rate index. The Wall Street Journal prints a composite prime rate change only when 23 of the 30 largest banks change their prime rates.

According to the WSJ, prime rate is the "base rate on corporate loans posted by at least 75 percent of the nation's 30 largest banks." Prime rates are usually three percentage points higher than the Federal Funds Rate, the interest rate that banks charge one another.

The Federal Reserve fixes the Federal Funds Rate, increasing the Federal Fund Rate to slow down the economy and lowering the rate to boost it. When the Federal Reserve changes the interest rates, the prime rate will also reflect these changes.

However, most corporate loans are indexed to LIBOR. Prime rates, though they should be 3 percent higher than Federal Fund Rates, are usually equal to LIBOR rates.

Determining Interest Rates

When giving loans, banks offer their consumers a rate determined by the sum of three factors: the prime rate; a variable percentage, which is determined by the lender's assessment of the risk in lending; and the loan's profit margin.

Prime rates and LIBOR rates greatly affect the interest rates of consumer loan products such as credit cards, home equity loans, auto loans, small business loans, personal loans, some private student loans, and other variable-rate loans.

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When a person borrows a loan, banks usually charge compound interest, which means that interest is calculated over the interest that has been added to the debt before. The frequency of compounding directly affects the total amount of interest paid over the life of the loan.

When a student borrows a loan with a LIBOR index, they can choose the frequency of the compounding, whether it is one month, six months, one year, or more. If a borrower has a one-month LIBOR rate, then the interest rate is fixed for that one-month period, and then compounded once every subsequent month.

To illustrate how this works, let's take a closer look at a specific scenario. If a student took out a $100,000 student loan with a one-year LIBOR rate and pays off her loans after 15 years, you can calculate the total amount by using the compounding formula,

$$A(t) = Ao(1+\frac{r}{n})^{n.t}.$$

Given that A0 is the principal amount borrowed, which is $100,000; that r is the interest rate, which is currently 5.2476 percent; that *n* is the number of compounding periods per year, which is one; and *n.t* is the total number of compounding periods, which would be 15; A(*t*), the total amount after 15 years, would be $215,368.91.

Let's look at another example where the student has a six-month LIBOR rate for a $100,000 loan. The interest rate, *r*, would be 5.1196 percent. The number of compounding periods per year would be 2, and the total number of compounding periods within 15 years would be 30. Using the same compound formula, the total amount after a 15-year period would be $213,459.

When calculating the interest rates for consolidation, your lender will take the weighted average of the interest rates on the loans being consolidated, then round it up to the nearest one-eighth percent. This new fixed interest rate will remain the same throughout the life of the loan.

Consolidation will allow you to lock in low interest rates before they increase. As a result, you will save money every single month on your payments and reduce the overall amount of interest you would have paid. Throughout the life of your loan, you may save up to 60 percent.

What to do during times of financial duress

After you graduate, you may have difficulty finding a job, much less a high-paying job. These situations may put undue financial stress on you. With a gazillion other bills to pay, you may not have enough extra cash to make monthly payments towards your school loans. Lenders know that life happens. It presents unexpected surprises and throws everything else off course.

For cases like these, lenders have created three different plans to help you get through rough times. The following explain your options:

Continued on back

Grace Period

For students who have consolidated while attending school, you may qualify for a 6-month grace period before you start repaying your debts. Your grace period will begin immediately after you are enrolled less than half-time at an eligible school.

If you have applied for consolidation, but your enrollment status drops below half-time before the first disbursement, you will not have to make consolidation payments for the remaining months in your grace period after you have received your first disbursement.

In order to qualify, you must meet all of the following conditions. First, you must have a Direct Loan or Federal Family Education Loan (FFEL) Program loan while you are in school. Third, your lender must receive your consolidation application before you graduate.

Varied Deferment Options

There are also different deferment options that will temporarily suspend the borrower's monthly loan payment.

Even though principal payments in both are postponed, deferment works differently for subsidized and unsubsidized loans. During the deferment of direct subsidized loans, interest is not charged to you. Instead, the government pays the interest on your behalf.

Whereas, during the deferment of direct unsubsidized loans, you will have to pay the interest accrual because the government will not. If the borrower chooses not to pay interest, then it will automatically be added to the principal balance of the loan, increasing the debt owed.

For loans that were disbursed after July 1, 1993, you may be eligible for the following five original deferment options. For loans taken out before July 1, 1993, you may have access to other deferment options not listed below. These are the options open to borrowers:

<u>In-school Deferment.</u> Borrowers must have Federal Stafford, Federal SLS, Federal Consolidation, or Federal PLUS Loans. In order to be eligible, the borrower must also be enrolled as a full-time or half-time student. No time limits are placed on this deferment.

<u>Graduate Fellowship Deferment.</u> To qualify, a borrower must be engaged in full-time student in an academic subject area in which he or she has been recommended by an institution of higher education. Oftentimes, the graduate fellowship deferment is given to borrowers who provide teaching and/or research assistance. Also, the deferment form must be signed by a program official, whether it is a dean, professor, director, or chief.

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In addition to needing a bachelor's degree, the candidate must have outstanding Federal Stafford, Supplemental, PLUS, or Consolidation Loans. There is no time limit on graduate fellowship deferments.

Rehabilitation Training Deferment. In order to be eligible, the borrower must be either scheduled to engage or already engaged in a full-time rehabilitation training program. These programs, which are offered by the Department of Veteran Affairs or state agency that oversees vocational rehabilitation, help those with mental health issues or those who abuse drugs or alcohol.

Additionally, the borrower must have a plan that specifies when rehabilitation is expected to end. Usually, the time spent in rehab should be significant enough to excuse your inability to work full-time.

Unemployment Deferment. You must be actively seeking, yet unable to obtain a full-time job that matches your level of expertise, salary, or responsibility. You will need to show that you made six attempts to find employment in the past six months if you cannot provide documentation that shows that you are eligible for unemployment benefits. Furthermore, you must be registered with an employment agency if there is one within a 50-mile radius from your address.

Unemployment deferment must be renewed every six months. It cannot be renewed more than six times.

Economic Hardship Deferment. The borrower must meet and provide necessary documentation for one of the following conditions: (1) The Federal Family Education Loan (FFEL) or the Federal Perkins Loan Program has granted you an economic hardship deferment; (2) You get financial aid from federal or state public assistance program, including Temporary Assistance for Needy Families (TANF), Supplemental Security Income (SSI), or food stamps; or (3) The monthly compensation for your full-time job meets specific federal requirements.

Economic hardship deferment must be renewed every 12 months and cannot be renewed more than three times.

Peace Corps Services Deferments. To qualify, you must volunteer in the Peace Corps. This deferment must be renewed every 12 months and cannot be renewed more than three times.

You may qualify for deferment if you still owe money on a FFEL Program loan that was made before July 1, 1993 and if you meet the following criteria:

You may qualify for a three year deferment if you are disabled, act as a caretaker for a disabled spouse or dependent, serve in the U.S. Armed Forces, serve in the Commissioned Corps of the Public Health Serve, serve in the National Oceanic and Atmospheric Administration Corps, teach in a designated area that lacks mentors, or if you volunteer full-time for a tax-exempt organization or ACTION program.

Continued on back

You may qualify for a two year deferment if you participate in a medical internship or residency program.

You may qualify for a one year deferment if you are a mother entering or re-entering the workforce.

You may qualify for a six month deferment if you are on parental leave.

Forbearance

For those who disqualify for deferment, you may try to qualify for forbearance, which is a reduction in payment amount or a temporary suspension of payments. If you are suffering financial duress, then your lender may choose to postpone your current payments. However, if you are currently able to make payments and unable to make up for previous delinquent payment, then your lender may grant you forbearance on your previous debt.

Some circumstances that allow for forbearance include economic hardship, illness, service as a medical or dental intern/resident, service for the nation and the subsequent reception of a national service education award under the National and Community Service Trust Act of 1993, or times when the monthly debt on your federal Title IV student loans equals or exceeds 20 percent of your monthly income.

It is important to remember that forbearance does not eradicate all previous debt. Instead, it relieves you from making mandatory monthly payments for a short while. During this time, your monthly debts and interest accrue, and you are still responsible for their eventual pay-off.

There are consequences worth considering. You will be paying interest on a larger amount of debt. Your interest will be added to your debt, which will increase your overall debt. You will pay more interest on this larger debt. The cycle continues. In short, because your debt increases with time, when you decide to start paying off your debts, you will have a higher monthly payment than you did before.

Each lender creates its own forbearance policies. In some cases, a lender may grant you a temporary forbearance of 60 days, so that they may evaluate your evidence of economic distress and process your documentation. In other cases, if you have not made a single payment, your lender may ask you prove your dedication to repay by asking you to make one or more payments to your account.

To see if you are qualified for forbearance, you should contact your loan provider.

Repayment Period

Consolidation offers flexible repayment options that, depending on the amount of debt you have accrued, may extend your repayment period from the usual 10 years to up to 30 years. There are pros and cons

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to both a shorter and lengthier repayment plan, but you should choose plans according to how much you are willing to dish out per month. You may have to consider the size of your debt and the amount you are currently making.

If you opt for a shorter repayment period, you will be making larger monthly payments, which may make you tight on expendable cash. However, you will have to pay less interest during the life of your loan.

If you choose to have a longer repayment period, you will make smaller monthly payments, which will allow you to meet other expenses, such as childcare, car payments, and mortgage payments. You will have more financial mobility than you would if you chose a shorter repayment period, but you will pay more interest over the life of your loan.

It's important to realize that Consolidation Loans give you the option to switch repayment plans at any time, so you can change your plan to accommodate to the financial changes in your life.

In any case, after your first disbursement, you will have to make your first payment within 30 days. If you are qualified for deferment or forbearance, the time periods for the following payment plans do not pertain to you. The following are your repayment options:

Standard Repayment Plan. This is a 10 year plan, which includes fixed monthly payments of at least $50. In cases where your loan is higher, your monthly payments will have to be adjusted to a higher rate to ensure that you repay all your debt within the specified time frame. Also, your monthly payment amount may adjust accordingly with the annual changes in variable interest rate.

Extended Repayment Plan. This plan allows you to pay your loans off by making fixed monthly payments within 12 to 30 years. The actual time frame depends on the size of your loan. Smaller debts get shorter payoff times; whereas, larger debts may extend to up to 30 years. Monthly payments must be at least $50, but may be higher if you have greater debt. Also, your monthly payment may adjust annually with changes to the interest rate.

Graduated Repayment Plan. With this plan, you must repay your loan within 12 to 30 years. The actual time frame is determined by the size of your loan. Monthly payments will start off low, but will gradually increase, often, after the first two years. The size of your monthly payments must be more than 50 percent and less than 150 percent of what you would pay had you opted for a Standard Repayment Plan. Also, your monthly payment may adjust annually with changes to the interest rate.

Income Contingent Repayment Plan. This plan will adjust your monthly repayment amount according to the size of your loan, your family size, and your income. The actual amount will adjust along with changes to your income and family size. In order to calculate the actual monthly payment, your lender has to obtain necessary information from the IRS. Until then, your payment will be based on the amount

Continued on back

of interest that has accrued on your debt. After 25 years, the portion of your unpaid loans will be forgiven.

Your lender will choose the appropriate repayment plan for you if you neglect to make your own decision. There are also alternative repayment options available for those who have proven to the Department of Education that there are special circumstances that make it difficult to comply with the existing plans listed above.

There are other issues regarding repayment. Firstly, you will not be penalized for prepaying your loan. Secondly, if you are 30 days late making a payment, then lenders may charge a late fee that should not exceed six cents for each late dollar owed. Thirdly, it is imperative to make your monthly payments even if you don't receive a reminder. It is your responsibility to ensure that your debts are being handled in a timely manner.

Which Loans May You Consolidate?

Ineligible Loans

There are some loans that cannot be consolidated, but may be used to determine the length of your repayment period under the Graduated and Extended Repayment Plans. These loans include:

- Primary Care Loans
- Medical Assist Loans
- Law Access Loans
- PLATO Loans
- Health Education Assistance Loans

Additionally, any other state or private loan that is not guaranteed by the federal government falls into this category.

Eligible Loans

The following loans may be consolidated:

- Federal Subsidized and Unsubsidized Federal Stafford Loans
- Direct Consolidation Loans and Federal Consolidation Loans
- Guaranteed Student Loans
- Federal Insured Student Loans
- Federal Supplemental Loans for Students
- Auxiliary Loans to Assist Students

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- Federal Perkins Loans
- National Direct Student Loans
- National Defense Student Loans
- Health Professions Student Loans
- Loans for Disadvantaged Students
- Nursing Student Loans

If you would like to consolidate Direct PLUS and Federal PLUS Loans before graduating, your parent borrower may consolidate other eligible, non-PLUS loans, too.

The Repercussions of Late Payment

If you have missed payments, it is possible that you are delinquent or in Federal Student Loan Default. Delinquency happens when you miss one payment. Consistently missing more than one payment will place you in default.

The consequences of default are vast and harsh. If you are in default, your employer may withhold your earnings from you and give it to the U.S. Department of Education. You may be deemed ineligible for other federal student aid and loan deferments. The government may withhold your federal income tax refund. You may lose loan benefits; lower interest rate incentives; deference, forbearance, and repayment options; and your eligibility for future financial aid. In more extreme cases, you may bear the brunt of costly legal action and collection charges.

Additionally, because the Credit Bureau will be informed regularly about the amount, disbursement, and repayment status of your loans, they will know if you are in default with your monthly payments. If you are in default, you will suffer from negative credit, which may have severe and long-lasting repercussions.

Negative credit will determine whether lenders will loan you money on homes, car, credit cards, and so on. Having bad credit may exclude you from loans altogether and subject you to higher interest rates.

To be fair, before your lender discloses your default status to a credit bureau, they will give a 30-day advanced notice. During this time, you may request a review of your debt, and the Department of Education is obligated to address your concerns in a timely manner. If, however, you repay your late debt within those 30 days, you will be relieved from your default status and bad credit.

If your monthly payments are too high, you may prevent your loans from defaulting by changing your repayment option or applying for deferment and forbearance. These options will either lower your monthly payments or stop your monthly payments altogether. However, the trade-off would be an extended loan life and greater aggregate debt.

Continued on back

Circumstances that Discharge You from Loan Payment

You may be discharged from repayment if documentation is provided that proves that you have died or have been permanently and totally disabled. If you want to be discharged based on a disability, then you must submit and have your doctor certify a discharge application to the Direct Loan Servicing Center.

If you and a spouse applied for the consolidation loan jointly, then you will only be discharged from future payments if there is documentation that shows that both of you are dead or permanently and totally disabled. If you both agree that you are both permanently and totally disabled, then you both must submit and have your doctor(s) certify the discharge applications.

You are not considered disabled if you have a condition that existed before you applied for any of your consolidated loans. The only exception is if a doctor verifies that your health has taken a downward turn, worsening beyond hope and repair.

Sometimes, parts of your debt may be discharged. Partial-discharge may be applicable if the shut down of your school prevented you from finishing your course load, or if your school mistakenly verified your consolidation eligibility. Also, if your school fails to provide you with a required refund, then you will receive a discharge amount equal to the refund amount.

If you are undergoing bankruptcy and would like to be discharged from monthly payments, then you must prove your financial distress in bankruptcy court.

Who Can Consolidate?

Students

If you are an *in-school borrower*, you may consolidate upon graduation, provided you have eligible loans meeting the minimum consolidation requirements.

If you are an out-of-school borrower, you may consolidate if you have at least one direct loan or FFEL loan meeting the minimum consolidation requirements.

Parents

If you are an *in-school parent borrower*, you may qualify for consolidation if you have a PLUS loan meeting the minimum consolidation requirements.

If you are an *out-of-school parent borrower* who wants to consolidate, you may have only PLUS loans or have PLUS loans and other student loans that you are currently paying.

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Married

Currently, joint consolidations are not allowed. If you consolidated with your spouse in prior years, you should realize that this is a *joint* consolidation. If you want deferment, forbearance, or discharge, both spouses must qualify. For example, you may not discharge consolidation simply because one of you dies or is permanently disabled. Both of you must die or be disabled in order to obtain discharge. If not, then the single borrower who survives carries the brunt of the financial burden.