

Welcome Planners

About Us

FPA Board

Become a Member

CFP Classes

Calendar Events

Newsletter

Helpful Articles

Community Service

Regulatory Update

Disclaimers

Helpful Links

CONSIDER STUDENT LOAN CONSOLIDATION CAREFULLY

Q. I have over \$25,000 in federal student loans and I'm having trouble paying them off. Should I get a consolidation loan?

A student consolidation loan can help, but there are some downsides and alternatives to think about before you commit.

Q. How does a consolidation loan work?

A student consolidation loan combines several federal student or parent loans into a single larger loan. Most federal loans can be consolidated: Stafford, PLUS (Parent Loans to Undergraduate Students), Supplemental, Direct, Perkins and others. Some lenders will consolidate private college loans as well. The U.S. Department of Education offers Direct Consolidation Loans (www.ed.gov/directloan/ or 800/557-7392), as do many private lenders (www.finaid.org links to several private lenders).

A consolidation loan reduces the size of the monthly payments, usually by extending the terms of the loan beyond the normal 10 years, to 20 or even 30 years. That makes it more manageable for borrowers to make payments, especially younger people lower on the pay scale. Sometimes consolidation is necessary for people to qualify for a home mortgage.

Consolidation may especially be warranted if you're not making payments and risk default on your loans. This will hurt your credit rating. Furthermore, the federal government can divert your tax refunds toward the loans or garnish your wages, even on very old student loans. Consolidation also can help you put the saved dollars toward higher-interest debt such as credit cards. Credit-card debt isn't tax deductible, while you may be able to deduct up to \$1,000 in

student loan interest.

Q. Will a consolidation loan reduce the interest rates I'm paying on my loans?

Not necessarily. The interest rate on the consolidation loan would be the weighted average of the interest rates of the loans you're consolidating, rounded up to the nearest 1/8 of a percent. Depending on weighting, you actually could end up paying a higher interest rate, though more likely the rate will be lower. Federal law requires variable-rate direct subsidized and unsubsidized consolidation loans to be capped at 8.25 percent, while PLUS consolidation loans are capped at 9 percent. Some experts are recommending consolidation as soon as possible because the rates will likely go up come July 1, 2000. That's when the government annually readjusts interest rates for the year for student loans, and those rates will likely reflect the recent climb in other types of interest rates.

Q. Are there downsides to consolidation?

The most obvious downside is that even though your payments are smaller, you are extending them over a longer time. That means you'll pay out more total interest. Also, as with any kind of consolidation loan, the borrower may be tempted to spend more or even borrow more because of the smaller loan payments. Then you're just piling up more debt than if you hadn't consolidated.

Q. Are there alternatives I should consider?

Try first to tighten up your budget to free up more dollars to meet your loan payments, or take on a second or better-paying job.

If you've managed to pay your nonconsolidated loans on time for close to 48 months, try to hang in there a little longer. Lenders commonly drop the interest rates significantly, say two percent, for borrowers who have paid on time for 48 months (sometimes for only 24 months)

Also check out two options offered by the federal loan program. The income-sensitive repayment option bases monthly payments on your total gross monthly income. Under the graduated payment option, payments start out smaller and increase gradually on the assumption that your earnings will increase. Increased payments cannot exceed three times the amount of the initial payment. Although the total interest you pay will increase under these options versus sticking to the original loan schedule, the increase



will be less than that of a consolidation loan.

You may be able to defer, or even outright cancel, a student loan if you teach in a low-income area or you teach full-time in a subject area that's short of teachers. You also may defer federal student loans if you're unemployed, return to school, go into the military or become disabled.

The important point is that while consolidation of an education loan may be the right choice for you, there are downsides and alternatives to consider before making a final decision.

[\[Home\]](#) [\[Welcome Planners\]](#) [\[About Us\]](#) [\[FPA Board of Directors\]](#)
[\[Become a Member\]](#)

[\[CFP Classes\]](#) [\[Calendar of Events\]](#) [\[Newsletter\]](#) [\[Helpful Articles\]](#)
[\[Planner Spotlight\]](#) [\[Community Servis\]](#) [\[Volunteers\]](#) [\[Hotline\]](#)

[\[Disclaimers\]](#) [\[Helpful Links\]](#)

Web site design
by
InkDrop Media
Group
jalguire@inkdrop.com

© Copyright 2000 - All Rights Reserved
The Financial Planning Association of San
Diego
info@fpasandiego.org