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Highlights

Highlights of GAO-04-101, a report to congressional requesters

Why GAO Did This Study

The federal government makes consolidation loans available to help borrowers manage their student loan debt. By combining loans into one and extending the repayment period, a consolidation loan reduces monthly repayments, which may lower default risk and, thereby, reduce federal costs of loan defaults. Consolidation loans also allow borrowers to lock in a fixed interest rate—an option not available for other student loans—and are available to borrowers regardless of financial need.

GAO was asked to examine (1) how consolidation borrowers differ from nonconsolidation borrowers; (2) how federal costs have been affected by recent interest rate and loan volume changes; and (3) the extent to which repayment options—other than consolidation—are available to help simplify and reduce loan repayments.

What GAO Recommends

GAO recommends that the Secretary of Education assess the advantages of consolidation loans for borrowers and the government in light of program costs and identify options for reducing federal costs. Options could include targeting the program to borrowers at risk of default and extending existing consolidation alternatives to more borrowers. Education should also consider how best to distribute program costs among borrowers, lenders and the taxpayers. Education agreed with our recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-04-101.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Cornelia Ashby at (202) 512-8403 or ashbyc@gao.gov.

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STUDENT LOAN PROGRAMS

As Federal Costs of Loan Consolidation Rise, Other Options Should Be Examined

What GAO Found

On average, consolidation loan borrowers, over the 1987 to 2002 period, had higher levels of student loan debt, higher incomes, and larger loan repayments than did nonconsolidation borrowers. For example, the average student loan debt among consolidation borrowers prior to consolidating their loans was about $22,000 versus about $10,000 for nonconsolidation borrowers. As a group, they defaulted less often on their consolidation loans than borrowers who did not consolidate their loans.

Recent trends in interest rates and consolidation loan volumes have affected consolidations in the Department of Education's (Education) two major student loan programs—the Federal Family Education Loan Program (FFELP) and the William D. Ford Federal Direct Loan Program (FDLP)—in different ways, but in the aggregate, estimated subsidy and administration costs have increased. Subsidy costs for FFELP consolidation loans grew from $1.3 billion for loans made in fiscal year 2002 to nearly $3 billion for loans made in fiscal year 2003. Lower interest rates available to borrowers in fiscal year 2003 increased these costs because FFELP consolidation loans carry a government-guaranteed rate of return to lenders that is projected to be higher than the fixed interest rate consolidation loan borrowers pay. Higher loan volumes also added to the estimated subsidy costs. Interest rates and loan volume also affected costs for FDLP consolidation loans, but in a different way. Because the interest rate the government charges borrowers has been somewhat greater than the interest rate that Education pays to finance its lending, consolidation loans have generated a net gain for the government in recent years. Lower rates paid by borrowers and reduced loan volume from recent record highs, however, reduced the net gain to $286 million for loans made in fiscal year 2003, down from $460 million the year before. While administration costs are not specifically tracked for either loan program, available evidence indicates that these costs have also risen.

Alternatives to consolidation, such as the ability to make a single repayment to cover multiple loans and obtain extended repayment terms, now give some borrowers opportunities to simplify and reduce loan repayments, but not all borrowers can use them. As a result, consolidation loans may be the only option for some borrowers to simplify and reduce repayments. Borrowers' repayment choices—whether to obtain a consolidation loan or use other alternatives—have consequences for federal costs. While consolidation loans may remain an important tool to help borrowers, overall federal costs in providing for consolidation loans may exceed federal savings from reduced defaults. An assessment of the advantages of consolidation loans for borrowers and the government, taking into account program costs and how costs could be distributed among borrowers, lenders, and the taxpayers, would be useful for decisionmakers.