MEMORANDUM May 6, 2014

To: Committee on Education and the Workforce
U.S. House of Representatives
Attention: Rich Williams

From: David P. Smole, Specialist in Education Policy

Subject: **The Student Loan Refinancing Act: calculations showing changes in loan payment amounts for three borrower cases**

This memorandum presents calculations showing how the amounts paid by borrowers of federal student loans made through the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Loan program[1] might be affected by the implementation of a student loan refinancing program that would be part of the Student Loan Refinancing Act.[2] The memorandum first provides a brief summary of the student loan refinancing program. It then presents calculations for three borrower cases identified by you: (1) an undergraduate student who borrowed a total of $30,000 in Direct Unsubsidized Loans, (2) a graduate student who borrowed a total of $40,000 in Direct Unsubsidized Loans, and (3) a parent of an undergraduate student who borrowed a total of $50,000 in PLUS Loans. As you requested, the cases are based on borrowers who refinance their loans one year into repayment. The results of the calculations show the differences between the amounts that the three cases of borrowers would pay on loans repaid under current law and on loans refinanced with lower interest rates. Given the degree of general interest in issues related to the refinancing of student loans, the information presented in memorandum may be used in whole or in part to respond to other congressional clients. You will not be identified as the original requester.

Refinancing Program for FFEL and Direct Loans

Section 2 of the Student Loan Refinancing Act would establish a refinancing program for borrowers of loans that were made through the FFEL and Direct Loan programs before July 1, 2013. It would also establish a refinancing program for borrowers of private education loans. (The analysis presented in this memorandum, however, is limited to the refinancing of federal student loans.) Under the refinancing program, the Secretary of Education (the Secretary) would be required to reissue pre-July 1, 2013 FFEL and Direct Loans as 'Refinanced Federal Direct Loans'.

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[1] For background on these types of federal student loans, see CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by David P. Smole.

[2] The analysis presented in this memorandum is based on a discussion draft of the Student Loan Refinancing Act provided to CRS on May 5, 2014.

Applicable Interest Rates

The interest rates that would apply to Refinanced Federal Direct Loans would be the fixed interest rates that are applicable to comparable loan types made during the period from July 1, 2013 through June 30, 2014.[3] **Table 1** presents the interest rate schedule that would apply to Refinanced Federal Direct Loans, based on the original loan type.

Table 1. Applicable Interest Rates on Refinanced Federal Direct Loans

Original Loan Type	Refinanced Federal Direct Loan interest rate
FFEL and Direct Loan program Subsidized Loans and Unsubsidized Loans to undergraduate students	3.86%
FFEL and Direct Loan program Subsidized Loans and Unsubsidized Loans to graduate and professional students	5.41%
FFEL and Direct Loan program PLUS Loans	6.41%
FFEL and Direct Loan program Consolidation Loans	6.41%

Source: Discussion draft, Student Loan Refinancing Act.

Administrative Fee

Upon a loan being refinanced, an administrative fee equal to no more than 0.5% of the amount of unpaid principal, unpaid interest, and late charges would be added to the principal balance of the loan.

Retention of Loan Term

Under the proposal, the reissuance of a loan with a lower interest rate would not result in an automatic extension of the repayment term. Rather, the borrower would retain the same repayment term that was in effect on the original loan. Thus, if a borrower refinanced one or more loans one year into repayment on a standard 10-year repayment plan, the borrower would have nine years remaining on his or her repayment term.

Income Requirements for Borrower Eligibility

The Secretary would be required to establish requirements for borrower eligibility to take advantage of the opportunity to refinance federal student loans at a lower interest rate. To target this benefit to borrowers with the greatest financial need, the Secretary would be required to establish borrower eligibility requirements that take into account borrower income or debt-to-income ratios.

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[3] The fixed interest rates in effect on Direct Loans made during the period from July 1, 2013 through June 30, 2014 are presented in Table 2 in CRS Report R40122, *Federal Student Loans Made Under the Federal Family Education Loan Program and the William D. Ford Federal Direct Loan Program: Terms and Conditions for Borrowers*, by David P. Smole.

Calculations of Differences in Loan Payment Amounts that Result from Refinancing for Three Borrower Cases

You requested calculations for three borrower cases showing differences between amounts that would be paid on pre-July 1, 2013 federal student loans and amounts that would paid upon those loans being refinanced into Refinanced Federal Direct Loans one year into repayment. These cases are summarized below.

1. An undergraduate student who borrowed a cumulative total of $30,000 in Direct Unsubsidized Loans. The borrower paid the interest that accrued in school and had a loan balance of $30,000 at the beginning of repayment. These loans were made with a fixed rate of 6.8%.
2. A graduate student who borrowed a cumulative total of $40,000 in Direct Unsubsidized Loans. The borrower paid the interest that accrued in school and had a loan balance of $40,000 at the beginning of repayment. These loans were made with a fixed rate of 6.8%.
3. A parent of an undergraduate dependent student who borrowed a cumulative total of $50,000 in PLUS Loans. The parent borrower paid the interest that accrued while the student was in school and had a loan balance of $50,000 at the beginning of repayment. These loans were made with a fixed rate of 7.9%.

Given more time, it would be possible to construct a set of more nuanced cases that would more fully reflect existing borrowers.

Assumptions

In preparing these calculations, a number of assumptions were made that take into account how currently applicable loan terms and conditions and aspects of the proposal would apply to the borrower cases examined. These assumptions include the following:

- Borrowers are repaying their loans according to a standard, 10-year repayment plan.
- For each of the three borrower cases, it is assumed that the borrowers made 12 monthly payments on their loans at the original interest rate prior to their loans being refinanced at the lower rates that apply to Direct Loans made during the period from July 1, 2013 through June 30, 2014.
- The Secretary charges the maximum authorized administrative fee of 0.5%. This charge is added to the loan principal at the time of refinancing.
- The Refinanced Federal Direct Loans are repaid over a period of nine years (108 monthly payments) at the newly applicable fixed interest rates.

Results of Calculations

Table 2 presents the results of calculations for the three specified cases that show how loan payment amounts would be affected by the refinancing program for FFEL and Direct Loans. These calculations may be helpful in illustrating possible effects of the newly available interest rates on loan repayment amounts.

Table 2. Student Loan Payments for Three Borrower Cases: Current Law and the Student Loan Refinancing Act

(amounts shown are dollars unless otherwise noted)

	Case 1. Undergraduate student borrower of Direct Unsubsidized Loans	Case 2. Graduate student borrower of Direct Unsubsidized Loans	Case 3. Parent borrower of Direct PLUS Loans
Pre-July 1, 2013 Loans			
Balance at start of repayment	30,000	40,000	50,000
Original interest rate	6.80%	6.80%	7.90%
Total interest paid	11,429	15,239	22,480
Total principal and interest paid	41,429	55,239	72,480
Monthly payment	345	460	604
Refinanced Federal Direct Loans			
Balance at start of repayment	30,000	40,000	50,000
Original interest rate	6.80%	6.80%	7.90%
Balance at refinancing (after 1 yr.)	27,830	37,107	46,580
Interest paid during first year	1,973	2,631	3,828
Administrative fee (0.5%)	139	186	233
Balance w/ admin. fee included	27,969	37,293	46,813
Refinanced interest rate	3.86%	5.41%	6.41%
Interest paid over last 9 years	5,184	9,895	14,916
Total interest paid over 10 years	7,157	12,526	18,744
Total principal and interest paid (includes admin. fee)	37,296	52,712	68,977
Monthly payment over last 9 years	307	437	572
Difference in Loan Payment Amounts			
Difference in interest payments	-4,272	-2,713	-3,736
Difference in total amount paid (includes admin. fee)	-4,133	-2,527	-3,503
Difference in monthly payment (final 9 years)	-38	-23	-32

Source: CRS analysis.

Interpretation of Results

Table 2 shows differences in loan payments that would result for three borrower cases from refinancing federal student loans at lower interest rates one year into a 10-year repayment term.

Case 1

For the undergraduate student borrower case, if the borrower repaid the entire $30,000 loan balance at a fixed rate of 6.8% over a 10-year repayment term, the borrower would pay a total of $11,429 in interest. The borrower would pay a total of $41,429 in principal and interest combined and the monthly payment would be $345.

If the undergraduate student borrower was able to refinance one year into repayment at a rate of 3.86%, the loan balance upon refinancing would be $27,830. If a 0.5% administrative fee was charged, the principal balance would increase to $27,969. After repaying the remainder of the loan balance at the lower 3.86% rate, the borrower would have paid a total of $7,157 in interest ($4,272 less than at currently applicable rates). The total amount paid, including the administrative fee, would be $37,296 ($4,133 less than at currently applicable rates). The monthly payment for the final nine years of repayment would be $307 ($38 less than on the original loan).

Case 2

For the graduate student borrower case, if the borrower repaid the entire $40,000 loan balance at a fixed rate of 6.8% over a 10-year repayment term, the borrower would pay a total of $15,239 in interest. The borrower would pay a total of $55,239 in principal and interest combined and the monthly payment would be $460.

If the graduate student borrower was able to refinance one year into repayment at a rate of 5.41%, the loan balance upon refinancing would be $37,107. If a 0.5% administrative fee was charged, the principal balance would increase to $37,293. After repaying the remainder of the loan balance at the lower 5.41% rate, the borrower would have paid a total of $9,895 in interest ($2,713 less than at currently applicable rates). The total amount paid, including the administrative fee, would be $52,712 ($2,527 less than at currently applicable rates). The monthly payment for the final nine years of repayment would be $437 ($23 less than on the original loan).

Case 3

For the parent borrower case, if the borrower repaid the entire $50,000 loan balance at a fixed rate of 7.9% over a 10-year repayment term, the borrower would pay a total of $22,480 in interest. The borrower would pay a total of $72,480 in principal and interest combined and the monthly payment would be $604.

If the parent borrower was able to refinance one year into repayment at a rate of 6.41%, the loan balance upon refinancing would be $46,580. If a 0.5% administrative fee was charged, the principal balance would increase to $46,813. After repaying the remainder of the loan balance at the lower 6.41% rate, the borrower would have paid a total of $18,744 in interest ($3,736 less than at currently applicable rates). The total amount paid, including the administrative fee, would be $68,977 ($3,503 less than at currently applicable rates). The monthly payment for the final nine years of repayment would be $572 ($32 less than on the original loan).

As noted above, these calculations assume a borrower refinances after one year of repayment at the initially applicable interest rate. Different results would be obtained if a borrower refinanced at a different point in repayment, or if a borrower was repaying according to a repayment plan that had a different repayment term.