1. Recent borrowers will generally not save on interest through consolidation. This is because interest rates on federal loans made after July 1, 2006, are fixed. The interest rates for consolidation loans are calculated based on the average interest rates of the loans being consolidated. Borrowers with variable-rate loans from before July 1, 2006, may be able to get interest rate reductions by consolidating. Lastly, unlike other Direct Loans, the fixed interest rate assigned to a Direct Consolidation Loan at origination is not capped. 20

2. Consolidation extends repayment. Though it often lowers monthly payments, consolidation creates more overall costs in interest over the life of the loan and extends loan obligations further into the future. If borrowers are close to paying off their loans, consolidation may not be worthwhile.

3. Borrowers may lose some rights by consolidating. This is most clearly a problem if the borrower consolidates federal loans into a private consolidation loan (they would lose the rights associated with federal loans). Borrowers may also lose some options and protections if they consolidate certain federal loans, particularly Perkins Loans, into other federal loan programs. Under the current and new Direct Loan regulations, borrowers whose Direct Loans are originated or consolidated prior to July 1, 2017, may rely on defenses based on school misconduct “that would give rise to a cause of action against the school under applicable State law.” 21 Under the new regulations, borrowers whose Direct Loans are originated or consolidated on or after July 1, 2017, would be limited to defenses based on their school’s breach of contract, substantial misrepresentation, or a nondefault, favorable contested judgment against the school. 22 While Direct Consolidation Loans that paid off non-Direct Loans will be eligible for the new borrower defense process, the rules will limit refunds of amounts already paid on non-Direct Loans prior to their consolidation into a Direct Consolidation Loan. 23 Prior to the July 1, 2017 effective date, the new administration delayed implementation of the borrower defense regulations. 24 However, a federal court vacated the regulatory delays as unlawful and the 2016 borrower defense regulations went into effect in October 2018. The Department proposed new regulations in July 2018, 25 but, as of March 2019, has not finalized the proposed rules. 26 Borrowers may experience significant delays, and some borrowers already report getting inaccurate or confusing information. In addition to reviewing the guidance in this treatise for pursuing options under the existing rules, advocates should check https://ifap.ed.gov and www.studentloanborrowerassistance.org for the most current status and guidance.

Parent PLUS loan borrowers should be especially careful. Neither parent PLUS loans nor consolidation loans that incorporated a parent PLUS loan are eligible for income-based repayment (IBR). Thus having one parent PLUS loan as part of a new consolidation loan will mean that the borrower cannot repay that new loan using IBR. 22 However, the borrower is eligible to repay through income-contingent repayment (ICR).

Borrowers with Direct PLUS Consolidation Loans should be able to consolidate these loans into non-PLUS Direct Consolidation Loans. It is unclear whether the limits on reconsolidation apply. 24 This should not be a problem for graduate PLUS loan borrowers. However, there have been reports that some graduate PLUS loan borrowers are denied access to IBR because of the Department’s failure to distinguish them from parent PLUS loan borrowers.

Borrowers planning to apply for public service forgiveness have another issue to consider. The Department takes the position that a borrower that has previously recorded time toward public service forgiveness will lose that time if the borrower consolidates prior loans into a new consolidation loan. This is likely to arise, for example, if a borrower has undergraduate loans and works for a while after college in a public service job. The borrower may later go to graduate school and take out new loans. In this case, if the borrower consolidates after graduate school, he or she will lose the time that was “banked” on the undergraduate loans while working after college. This borrower should either not add the undergraduate loans to the new consolidation or decide not to consolidate.

The following are the main advantages of consolidation, beyond its value as a method of default resolution:

1. Consolidation allows borrowers to put all of their loans together and make just one monthly payment.
2. Consolidation might help if borrowers need to reduce payments through an extension of the repayment period. (Extending the length of repayment increases the total amount borrowers have to repay over the life of the loan.)
3. Borrowers may get an interest rate break, especially if they have variable-rate loans.
4. Consolidation gives borrowers the opportunity to select a new servicer. However, given the potential negative consequences of consolidating, borrowers should be careful if choosing to consolidate exclusively for this reason.
There are also a growing number of private consolidation loan products. Many of these lenders went out of business during the credit crisis or stopped making these loans, but these products are returning as the economy recovers. Many of these lenders encouraged or even pressured government loan borrowers to consolidate into a private consolidation loan. In these cases, borrowers will lose their rights available under the federal student loan programs, including rights to deferment and forbearance, income-based and other flexible repayment plans, statutory discharge and forgiveness programs, and other benefits available through the government loan programs.

Footnotes

70 [70] See U.S. Dep’t of Educ., Fed. Student Aid, Loan Consolidation [1] (“A Direct Consolidation Loan has a fixed interest rate for the life of the loan. The fixed rate is the weighted average of the interest rates on the loans being consolidated, rounded up to the nearest one-eighth of 1%. There is no cap on the interest rate of a Direct Consolidation Loan.”), available at https://studentaid.ed.gov.

Each year, the Department announces interest rates on various loan types for future award years. For a glimpse at current interest rates and a discussion of the formula used to calculate interest rates, see U.S. Dep’t of Educ., Electronic Announcement, Interest Rates for Direct Loans First Disbursed Between July 1, 2018 and June 30, 2019 [2] (May 18, 2018) (interest rates ranging from 5.05%, for Direct Subsidized Loans, to 7.60%, for Direct PLUS Loans), available at https://ifap.ed.gov.

71 [71] 81 Fed. Reg. 75,926, 76,080 (Nov. 1, 2016) (amending § 685.206(c)(1)).

72 [72] 81 Fed. Reg. 75,926, 76,083 (Nov. 1, 2016) (adding § 685.222(b)–(d)).

For more information on a borrower’s right to assert a defense to repayment based on school misconduct, see §§ 10.6.2 [3], 10.6.3, [4] infra.

73 [73] See § 10.6.3 [5], infra.


76 [76] See § 10.6 [6], infra.

77 [77] 34 C.F.R. § 685.221(a) (providing that parent PLUS loans and consolidation loans that repaid a parent PLUS loan cannot be repaid using IBR). See § 3.3.3.2 [7], infra.

78 [78] The Direct Loan regulations at 34 C.F.R. § 685.220 apply limitations when a borrower is attempting to reconsolidate a Direct Consolidation Loan. Direct PLUS Consolidation Loans are defined separately in the regulations and therefore may not be included in the category of “Direct Consolidation Loans.”
1.4.1.3.3 Pros and cons of consolidation

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