



Highlights of [GAO-04-568T](#), a testimony for the Committee on Education and the Workforce, House of Representatives

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 loan default costs. 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. This testimony is based on GAO's October 2003 report and addresses (1) recent changes in interest rates and consolidation loan volume and (2) how these changes have affected federal costs.

What GAO Recommends

In GAO's prior report, it recommended that Education assess the advantages of consolidation loans for borrowers and the government in light of program costs and identify options to reduce federal costs. GAO suggested that options could include targeting the program to borrowers at risk of default and changing from a fixed to a variable rate the interest charged to borrowers. Furthermore, GAO recommended Education consider how best to distribute program costs among borrowers, lenders, and the taxpayers and, if statutory changes were necessary to implement more cost-effective repayment options, to seek such changes from Congress. Education agreed with our recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-04-568T.

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.

STUDENT LOAN PROGRAMS

Lower Interest Rates and Higher Loan Volume Have Increased Federal Consolidation Loan Costs

What GAO Found

Recent years have seen a drop in interest rates for student loan borrowers along with dramatic overall growth in consolidation loan volume. From July 2000 to June 2003, the interest rate for consolidation loans dropped by more than half, with consolidation loan borrowers obtaining rates as low as 3.50 percent as of July 1, 2003. From fiscal year 1998 through fiscal year 2003, the volume of consolidation loans made (or "originated") rose from \$5.8 billion to over \$41 billion. The dramatic growth in consolidation loan volume in recent years is due in part to declining interest rates that have made it attractive for many borrowers to consolidate their variable rate student loans at a low, fixed rate.

Recent trends in interest rates and consolidation loan volume have affected the costs of the Federal Family Education Loan Program (FFELP) and William D. Ford Federal Direct Loan Program (FDLP) in different ways, but in the aggregate, estimated subsidy and administration costs have increased. For FFELP consolidation loans, subsidy costs grew from \$0.651 billion for loans made in fiscal year 2002 to \$2.135 billion for loans made in fiscal year 2003. Both higher loan volumes and lower interest rates available to borrowers in fiscal year 2003 increased these costs. Lower interest rates 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 paid by consolidation loan borrowers. When the interest rate paid by borrowers does not provide the full guaranteed rate to lenders, the federal government must pay lenders the difference. FDLP consolidation loans are made by the government and thus carry no interest rate guarantee to lenders, but changing interest rates and loan volumes affected costs in this program as well. In both fiscal years 2002 and 2003, there was no net subsidy cost to the government because the interest rate paid by borrowers who consolidated their loans was greater than the interest rate the Department of Education must pay to the Department of Treasury to finance its lending. However, the drop in loan volume and interest rates that occurred in fiscal year 2003 contributed to cutting the government's estimated net gain from \$570 million in fiscal year 2002 to \$543 million for loans made in fiscal year 2003. Administration costs are not specifically tracked for either consolidation loan program, but available evidence indicates that these costs have risen, primarily reflecting increased overall loan volumes.