




---

**Memorandum**

March 24, 2004

**TO:** House Committee on Education and the Workforce

**FROM:** Adam Stoll  
Specialist in Social Legislation  
Domestic Social Policy Division

**SUBJECT: Case Simulations Projecting Consolidation Loan Borrower Interest Rates**

---

This memorandum presents results from a set of case simulations. As you requested, I constructed these simulations to examine the loan repayment amounts a hypothetical borrower would face under two specific scenarios.

Under the first scenario, the borrower consolidates outstanding Stafford loans under the existing Federal Family Education Loan (FFEL) program consolidation loan interest rate formula while nearing the end of the grace period. Under this scenario (assuming the borrower's Stafford loans have all been disbursed since July 1, 1998) the borrower would secure a 2.88% fixed interest rate on a consolidation loan.

Under the second scenario, the borrower consolidates outstanding Stafford loans under an alternative set of rules whereby consolidation loan borrowers would no longer receive a fixed rate on consolidation loans. Instead the borrower's interest rate would continue to be determined by the Stafford loan variable interest rate setting formula even after the loans have been consolidated. It is assumed once again that the borrower's underlying Stafford loans have all been disbursed since July 1, 1998. Estimates of future borrower rates under this variable rate formula are based upon Congressional Budget Office (CBO) 91-day Treasury bill rate projections.<sup>1</sup> The estimated annual percentage rate the borrower would pay while in repayment under this scenario is 5.97% over a 10-year repayment term and 6.24% over a 15-year repayment term.

---

<sup>1</sup> Rate projections provide a sense of the direction in which rates will move and the magnitude of such movement. Projections do, however, contain some degree of imprecision. Based upon CBO's analysis of its own forecast record it finds that the average difference between its two-year forecasts and actual outcomes over the past 20 years was 1 percentage point. It is reasonable to assume that longer term projections may be less precise.

## CRS-2

For the sake of this exercise I have assumed that the borrower's outstanding debt is \$17,000 (roughly the average amount of federal student loan debt of graduating undergraduate borrowers).<sup>2</sup> Additionally, I have assumed that under each scenario the borrower would enter repayment in July 2004 and remain in repayment continually over an entire 10- or 15-year repayment term.

**Table 1** presents the results from these case simulations. Estimated repayment amounts are presented for a 10-year repayment period and a 15-year repayment period. Under consolidation loans, borrowers possessing this level of debt could select either repayment term. Please note that the total repayment amounts and total interest payments presented in **Table 1** are estimates of actual payment amounts made over the life of the loan. No attempt has been made to compute the present value of those payments.

**Table 1. Estimated Total Interest Payments and Total Loan Payments for a Hypothetical Borrower Under Current and Alternative Rate Setting Formulas**

Interest rate formula	Repayment term	Borrower interest rate	Loan amount	Total interest payments	Total loan payments
<b>Current formula:</b> The weighted average of interest rates on the loans consolidated, rounded to the nearest higher one-eighth of 1%, capped at 8.25%	10 years	2.88% fixed rate	\$17,000	\$2,581	\$19,581
	15 years	2.88% fixed rate	\$17,000	<u>\$3,948</u>	\$20,948
<b>Alternative Formula:</b> 91-day Treasury bill + 2.3, capped at 8.25% <sup>a</sup>	10 years	5.97% APR <sup>b</sup>	\$17,000	\$5,696	\$22,696
	15 years	6.24% APR <sup>b</sup>	\$17,000	<u>\$9,432</u>	\$26,432

**Source:** CRS calculations.

- a. Projections of bond equivalent rates of 91-day treasury bill rates from CBO's Mar. 2004 baseline projections for student loan programs have been used to calculate borrower interest rate estimates for future years.
- b. The APR is the estimated annual percentage rate paid to the lender under this variable rate formula.

I hope this is helpful. Please contact me at 7-4375 if I can be of further assistance.

<sup>2</sup> NCES, *Student Financing of Undergraduate Education: 1999-2000*, p.59.