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Highlights

Highlights of GAO-06-195, a report to the Ranking Minority Member, Committee on Education and the Workforce, House of Representatives

December 2005

STUDENT CONSOLIDATION LOANS

Potential Effects of Making Fiscal Year 2006 Consolidation Loans Exclusively through the Direct Loan Program

Why GAO Did This Study

Under the Federal Family Education Loan Program (FFELP) and the Federal Direct Loan Program (FDLP), the government guarantees and makes consolidation loans to help borrowers manage their student loan debt. By combining loans into one and extending repayment, monthly repayments are reduced. Unlike other student loans, consolidation loans carry a fixed interest rate. Recently, trends in interest rates and consolidation loan volume have increased overall federal costs, leading Congress to consider cost reduction proposals. Under the Federal Credit Reform Act, the government calculates, for budgetary purposes, the net cost, or "subsidy cost," of extending or guaranteeing credit over the life of loans. Agencies generally reestimate, subsidy costs annually to include actual results and adjust future program estimates.

GAO was asked to provide information on the budgetary effects of making consolidation loans exclusively through FDLP. We developed information to answer the following questions: (1) What would be the estimated budgetary effect of providing consolidation loans exclusively through FDLP in fiscal year 2006? (2) To what extent and for what reasons might this estimated budgetary effect change as subsidy costs are reestimated in future years? (3) How might FFELP lenders and borrowers be affected if consolidation loans were made exclusively through FDLP?

www.gao.gov/cgi-bin/getrpt?GAO-06-195.

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.

What GAO Found

Providing consolidation loans exclusively through FDLP in fiscal year 2006 could yield estimated budgetary cost savings of about $3.1 billion, based on subsidy cost estimates in the President's fiscal year 2006 budget, but actual savings would remain unknown until all loans made in fiscal year 2006 are repaid. In addition, federal administrative costs, which are not included in subsidy cost estimates, would likely increase and offset estimated subsidy cost savings by about $46 million over the life of the loans, based on Department of Education (Education) estimates, because FDLP administrative costs are higher than those of FFELP. Tax revenues, which could affect estimated savings, are also excluded from subsidy cost estimates. The $3.1 billion estimated savings result from

- avoiding an estimated subsidy cost of $2.5 billion for providing a projected volume of $25.5 billion in FFELP consolidation loans, and
- an estimated gain to the federal government of $620 million if the projected FFELP consolidation loan volume of $25.5 billion were made through FDLP rather than through FFELP.

The $2.5 billion estimated subsidy costs for FFELP consolidation loans is based in part on the fact that the government-guaranteed minimum yield provided to FFELP lenders, which varies based on market interest rates, was projected to be higher over the life of the loans than the fixed interest rate borrowers would pay. For FDLP loans, the fixed interest rate borrowers would pay was projected to be higher than the rate Education would pay to finance its lending, a fact that, in combination with other assumptions, resulted in a gain to the government for these loans.

The estimated subsidy cost savings from providing consolidation loans exclusively through FDLP could change significantly because of changes in assumptions underlying subsidy cost estimates. Key assumptions include (1) economic conditions, such as interest rates; (2) loan performance, such as the portion of loans that default; and (3) loan volume.

In estimating consolidation loan subsidy costs, Education must make assumptions about cash flows generated many years in the future. Such assumptions are periodically revised as new data about the assumptions and actual loan volume and costs incurred are known. As a result, subsequent subsidy cost reestimates could change substantially from initial estimates, thereby substantially changing the estimated budgetary effect.

The actual impact on lenders and borrowers of making consolidation loans exclusively through FDLP is difficult to predict, but according to lenders, consolidating all loans through FDLP would reduce lender revenues and borrower benefits, such as on-time repayment incentives. These potential impacts could be somewhat offset, however, by other factors. For example, some lenders told us that they would consider providing nonconsolidation loan borrowers alternative repayment options and other incentives to encourage them not to consolidate their loans. If successful, lenders would continue to earn income from loans not consolidated.