Interest Rates on Subsidized Stafford Loans to Undergraduate Students

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Summary

Subsidized Stafford Loans are one of the types of federal student loans made available through the William D. Ford Federal Direct Loan (DL) program, authorized under Title IV, Part D of the Higher Education Act of 1965. These loans are only available to students who demonstrate financial need. Beginning July 1, 2012, Subsidized Stafford Loans will be available exclusively to undergraduate students. The federal government "subsidizes" these loans by relieving the borrower of the requirement to pay the interest that accrues while the borrower is in school and during other authorized periods.

Fixed interest rates apply to all Subsidized Stafford Loans made on or after July 1, 2006—during award year (AY) 2006-2007 and all subsequent award years. During AY2006-2007 and AY2007-2008, Subsidized Stafford Loans to undergraduate students were made with a fixed rate of 6.8%. The College Cost Reduction and Access Act of 2007 (CCRAA; P.L. 110-84) set lower interest rates on Subsidized Stafford Loans made to undergraduate students during AY2008-2009 through AY2011-2012. Different, incrementally lower interest rates were set for loans made during each of these years. Subsidized Stafford Loans made to undergraduate students during the current award year, AY2011-2012, have a fixed interest rate of 3.4%. The CCRAA amendments do not apply to loans scheduled to be made during the upcoming 2012-2013 award year, which under current law will have a fixed interest rate of 6.8%.

In the 112th Congress, proposals have been made to reduce the interest rate applicable to Subsidized Stafford Loans that will be made to undergraduate students during AY2012-2013 from 6.8% to 3.4%. Proposals include H.R. 4628, the Interest Rate Reduction Act, and S. 2343, the Stop the Student Loan Interest Rate Hike Act of 2012. It is estimated that a reduction in the interest rate would benefit approximately 7.4 million students who are likely to borrow Subsidized Stafford Loans during the upcoming award year.

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The William D. Ford Federal Direct Loan (DL) program, authorized under Title IV, Part D of the Higher Education Act of 1965 (HEA; P.L. 89-329), as amended, is the primary federal student loan program administered by the U.S. Department of Education. Several types of federal student loans are made available through the DL program to undergraduate and graduate students and to the parents of dependent undergraduate students to help them finance their postsecondary education expenses. These are Subsidized Stafford Loans, Unsubsidized Stafford Loans, PLUS Loans, and Consolidation Loans. The terms and conditions of federal student loans are specific to when the loan is made and may also depend on when a borrower first obtained a federal student loan.[1] This report examines the interest rates that are applicable to Subsidized Stafford Loans borrowed by undergraduate students.

Subsidized Stafford Loans to Undergraduate Students

Subsidized Stafford Loans are only available to students who demonstrate financial need. Beginning July 1, 2012, Subsidized Stafford Loans will be available exclusively to undergraduate students.[2] The federal government "subsidizes" these loans by relieving the borrower of the requirement to pay the interest that accrues during certain periods. For loans currently being made, the interest is subsidized by the government while the borrower is enrolled in an eligible postsecondary education program of study on at least a half-time basis (in-school), during a six-month grace period that begins once a borrower first ceases to be enrolled in school on at least a half-time basis, and during periods when a borrower is eligible to defer making payments (deferment). For Subsidized Stafford Loans that will be made between July 1, 2012, and June 30, 2014, (during AY2012-2013 and AY2013-2014) the interest will be subsidized during in-school and deferment periods but not during the six-month grace period.[3] Students must begin repaying their loans at the end of the six-month grace period.

Subsidized Stafford Loans are a form of need-based federal student aid. To borrow a Subsidized Stafford Loan, a student must establish financial need through federal need analysis procedures. According to federal rules, the amount a student may borrow through a Subsidized Stafford Loan is determined by subtracting the sum of the student's expected family contribution (EFC) and estimated financial assistance (EFA) from other sources (e.g., scholarships, grants, other loans, and other assistance) from the cost of attendance (COA) of the school the student attends. Each year, students may borrow Subsidized Stafford Loans in amounts up to the lesser of the amount that their school's cost of attendance exceeds their EFC and EFA, or the annual loan limit applicable to their class level. Currently, annual loan limits for Subsidized Stafford Loans to

[1] In general, loan terms and conditions are specific to the date on which the first disbursement of the loan is made. However, certain loan terms and conditions are specific to the date on which the borrower first obtained a federal student loan made under HEA, Title IV. For additional information on loans made through the DL program, 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] Authority to make Subsidized Stafford Loans to graduate and professional students was terminated by the Budget Control Act of 2011 (BCA; P.L. 112-25). For additional information on BCA amendments, see CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan.

[3] Interest subsidies were eliminated on loans disbursed during this two-year period by the Consolidated Appropriations Act, 2012 (P.L. 112-74). For additional information on P.L. 112-74, see CRS Report R42010, *Labor, Health and Human Services, and Education: FY2012 Appropriations*, coordinated by Karen E. Lynch.

undergraduate students are $3,500 for first-year students, $4,500 for second-year students, and $5,500 for students in their third year of undergraduate studies or beyond. Undergraduate students may borrow up to a cumulative maximum of $23,000 in Subsidized Stafford Loans.

Interest Rates

The interest rates applicable to Subsidized Stafford Loans are established by statute. Applicable interest rates have changed numerous times throughout the history of the federal student loan programs, including changes between fixed interest rates and variable interest rate formulas. Like many other loan terms and conditions, the interest rate or interest rate formula applicable to a loan depends on when the loan is made. A brief history of interest rates and interest rate formulas that have been applicable to Subsidized Stafford Loans since the establishment of the DL program is provided below.

Variable Rate Loans

When the DL program was first established, Subsidized Stafford Loans were made with variable interest rates. Loans disbursed on or after October 1, 1992, and before July 1, 2006, are variable rate loans, on which rates adjust annually.[4] The formula used to calculate the variable interest rate for these loans, many of which are still outstanding, is determined by statute and stays in effect from the time the loan is disbursed through the life of the loan (provided that the loan is not consolidated into a fixed-rate Consolidation Loan).[5] The rates for these Stafford Loans are determined every June 1, and they become effective July 1 for the following 12-month period. The variable rate is calculated based on the bond equivalent rate of the 91-day Treasury bill,[6] plus a premium that differs depending on whether the borrower is in school or in repayment. For loans made from July 1, 1998, through June 30, 2006, the borrower interest rate is based on the 91-day Treasury bill plus 1.7 percentage points for borrowers who are in school, grace, or deferment; and the 91-day Treasury bill plus 2.3 percentage points for borrowers who are in repayment.[7] The maximum interest rate that may apply to Stafford Loans disbursed during this period is capped at 8.25%. Interest rates in effect during repayment on Subsidized Stafford Loans made since the establishment of the DL program are presented below in **Table 1**.

[4] For all Stafford Loans first disbursed on or after July 1, 1994, the applicable interest rate, and whether the rate is fixed or variable, depends on the date the first disbursement of a borrower's loan is made. Previously, applicable interest rates depended largely on whether a borrower had outstanding loans at the time of borrowing an additional loan.

[5] If a variable rate loan is consolidated into a new Consolidation Loan, the interest rate becomes fixed. At present, the interest rate on Consolidation Loans is the weighted average of the interest rates in effect on the underlying loans, at the time of consolidation, rounded up to the nearest higher one-eighth of 1%, and capped at 8.25%. Previously, other rate setting formulas applied to Consolidation Loans.

[6] Interest rates are adjusted annually based on the bond equivalent rate of the 91-day Treasury bill at the final auction held prior to June 1.

[7] Differential rates between in-school, grace, and deferment period, and the repayment period were established when Stafford Loans were primarily made through the Federal Family Education Loan (FFEL) program because loan servicing costs are lower during the in-school, grace, and deferment periods, when no payments are required. On Subsidized Stafford Loans, a lower interest rate during in-school, grace, and deferment periods does not directly impact the amount owed by the borrower, as the interest is subsidized by the government during these periods.

Table 1. Stafford Loan Interest Rates in Effect During Repayment: 1993-1994 through 2012-2013

Interest Rate in Effect (Jul. 1— Jun. 30)	Disbursement Period									
	Oct. 1, 1992— Jun. 30, 1994	Jul. 1, 1994— Jun. 30, 1995	Jul. 1, 1995— Jun. 30, 1998	Jul. 1, 1998— Jun. 30, 2006	Jul. 1, 2006— Jun. 30, 2008	Jul. 1, 2008— Jun. 30, 2009	Jul. 1, 2009— Jun. 30, 2010	Jul. 1, 2011— Jun. 30, 2011	Jul. 1, 2011— Jun. 30, 2012	Jul. 1, 2012— Jun. 30, 2013
1993-1994	6.22									
1994-1995	7.43	7.43								
1995-1996	8.92	8.25	8.25							
1996-1997	8.26	8.25	8.25							
1997-1998	8.26	8.25	8.25							
1998-1999	8.26	8.25	8.25	7.46						
1999-2000	7.72	7.72	7.72	6.92						
2000-2001	8.99	8.25	8.25	8.19						
2001-2002	6.79	6.79	6.79	5.99						
2002-2003	4.86	4.86	4.86	4.06						
2003-2004	4.22	4.22	4.22	3.42						
2004-2005	4.17	4.17	4.17	3.37						
2005-2006	6.10	6.10	6.10	5.30						
2006-2007	7.94	7.94	7.94	7.14	6.80					
2007-2008	8.02	8.02	8.02	7.22	6.80					
2008-2009	5.01	5.01	5.01	4.21	6.80	6.00				
2009-2010	3.28	3.28	3.28	2.48	6.80	6.00	5.60			
2010-2011	3.27	3.27	3.27	2.47	6.80	6.00	5.60	4.50		
2011-2012	3.16	3.16	3.16	2.36	6.80	6.00	5.60	4.50	3.40	
2012-2013	TBD[a]	TBD[a]	TBD[a]	TBD[a]	6.80	6.00	5.60	4.50	3.40	6.80

Sources: U.S. Dept. of Education, Office of Federal Student Aid, FFEL Variable Interest Rates; and 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.

a. Interest rate yet to be determined.

Fixed Rate Loans

In 2002, legislation was enacted to transition to a fixed interest rate structure for student loans. On student loans with a fixed interest rate, the interest rate that is in effect at the time the loan is made remains in effect until the loan is paid in full. P.L. 107-139 amended the HEA to specify that all Stafford Loans made on or after July 1, 2006, would have a fixed interest rate of 6.8%.

In 2007, the College Cost Reduction and Access Act of 2007 (CCRAA; P.L. 110-84) set incrementally lower fixed interest rates on Subsidized Stafford Loans made to undergraduate students during the four-year period from July 1, 2008, through July 1, 2012 (AY2008-2009 through AY2011-2012).[8] The CCRAA did not make any changes to the interest rate specified for Subsidized Stafford Loans made to undergraduate students on or after July 1, 2012, which remains at 6.8% under current law.

Current Legislative Proposals

In the 112th Congress, proposals have been made to reduce the interest rate applicable to Subsidized Stafford Loans made to undergraduate students below the fixed rate of 6.8% scheduled to apply to loans made during AY2012-2013.

President's FY2013 Budget

As part of the President's budget for FY2013, the Obama Administration proposed reducing the interest rate that would apply to Subsidized Stafford Loans made to undergraduate students during AY2012-2013 from 6.8% to 3.4%.[9] Loans made during subsequent award years would not be affected by the proposal and would be made with a fixed interest rate of 6.8%. The Administration has indicated that this change would affect 7.4 million borrowers.[10] The Congressional Budget Office (CBO) estimates that lowering the interest rate on Subsidized Stafford Loans made to undergraduate students during AY2012-2013 from 6.8% to 3.4% would lead to in increase of $6.0 billion in mandatory spending during the period from FY2012 through FY2022.[11] The Administration also proposed eliminating the interest subsidy on Subsidized Stafford Loans for borrowers who remain in school beyond 150% of their program length.[12]

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[8] These lower interest rates were offset by savings in mandatory spending generated by changes made to the FFEL program; however, the savings were not sufficient to pay for reduced interest rates on loans made during subsequent award years. For additional information on amendments made to the HEA by the CCRAA, see CRS Report RL34077, *Student Loans, Student Aid, and FY2008 Budget Reconciliation*, by Adam Stoll, David P. Smole, and Charmaine Mercer.

[9] U.S. Department of Education, FY2013 Justification of Appropriation Estimates to the Congress, "Student Loans Overview," at http://www2.ed.gov/about/overview/budget/budget13/justifications/r-loansoverview.pdf.

[10] U.S. Department of Education, "President Obama Calls on Congress to Prevent Student Loan Interest Rates from Doubling," The Official Blog of the U.S. Department of Education, April 21, 2012, http://www.ed.gov/blog/2012/04/president-obama-calls-on-congress-to-prevent-student-loan-interest-rates-from-doubling/.

[11] Congressional Budget Office, CBO's Reestimate of the President's 2013 Mandatory Proposals for Postsecondary Education, March 2012, http://www.cbo.gov/sites/default/files/cbofiles/attachments/43101_HigherEducation_PresidentsFiscal2013PoliciesReestimated.pdf.

[12] U.S. Department of Education, FY2013 Justification of Appropriation Estimates to the Congress, "Student Loans (continued...)

Legislation in the 112th Congress

In the 112th Congress, several bills have been introduced that would reduce the interest rate on Subsidized Stafford Loans to undergraduate students.[13] Most of these proposals would reduce the interest rate to 3.4% from the rate of 6.8% scheduled to apply to Subsidized Stafford Loans made to undergraduate students during the upcoming award year—AY2012-2013. Two proposals have been scheduled for consideration by the House and the Senate: H.R. 4628 and S. 2343.

H.R. 4628, the Interest Rate Reduction Act

H.R. 4628 would reduce the interest rate from 6.8% to 3.4% on Subsidized Stafford Loans made to undergraduate students during AY2012-2013. It would not change the interest rate of 6.8% scheduled to apply to loans made on or after July 1, 2013. To offset the increase in mandatory spending, H.R. 4628 would repeal the Prevention and Public Health Fund (PPHF) authorized under Section 4002 of the Patient Protection and Affordable Care Act (ACA; P.L. 111-148), as amended, and rescind the balance of unobligated monies made available for the fund.[14] Under current law, PPHF funds are to be transferred by the Secretary of Health and Human Services (HHS) to "programs authorized by the Public Health Service Act [PHSA], for prevention, wellness, and public health activities including prevention research, health screenings, and initiatives, such as the Community Transformation grant program, the Education and Outreach Campaign Regarding Preventive Benefits, and immunization programs."

On April 27, 2012, the House passed H.R. 4628 by a vote of 215 to 195.

S. 2343, the Stop the Student Loan Interest Rate Hike Act of 2012

S. 2343 would reduce the interest rate from 6.8% to 3.4% on Subsidized Stafford Loans made to undergraduate students during AY2012-2013. It would not change the interest rate of 6.8% scheduled to apply to loans made on or after July 1, 2013. To offset the increase in mandatory spending, S. 2343 would amend the Internal Revenue Code of 1986 (IRC), as amended, and the Social Security Act (SSA), as amended.[15] These amendments would require taxpayers with modified adjusted gross income in excess of $250,000 to pay self-employment taxes (Social Security and Medicare) on certain income currently exempt from self-employment taxes if that income is received from a professional service partnership or a professional service S corporation in which at least 75% of gross income is attributable to three or fewer shareholders.[16]

(...continued)

Overview," at http://www2.ed.gov/about/overview/budget/budget13/justifications/r-loansoverview.pdf.

[13] These include H.R. 3826, H.R. 4170, H.R. 4628, H.R. 4816, S. 2051, S. 2343, S. 2366.

[14] For information on the budgetary effects of H.R. 4628, see CBO, "Estimate of Budgetary Effects of H.R. 4628, the Interest Rate Reduction Act, as Introduced on April 25, 2012," April 26, 2012.

[15] For information on the budgetary effects of S. 2343, see CBO. "Estimate of Budgetary Effects of S. 2343, the Stop the Student Loan Interest Rate Hike Act of 2012, as Introduced on April 24, 2012," April 25, 2012.

[16] For additional information on S corporations and how they might be affected by S. 2343, see CRS Report R40748, *Business Organizational Choices: Taxation and Responses to Legislative Changes*, by Mark P. Keightley.

Potential Benefits to Borrowers of Proposed Interest Rate Reductions

Both H.R. 4628 and S. 2343 would reduce the interest rate to 3.4% from the rate of 6.8% scheduled to apply to Subsidized Stafford Loans made to undergraduate students during AY2012-2013. The value of an interest rate reduction to a borrower depends primarily on the amount borrowed during AY2012-2013 and the duration of the period over which the borrower repays the loan. The Administration estimates that approximately 7.4 million undergraduate students will borrow Subsidized Stafford Loans during AY2012-2013.[17] During this period, it is estimated that the average loan amount will be approximately $3,385.[18]

Table 2 presents estimates of the potential savings to borrowers in total interest paid that would result from a reduction in the interest rate from 6.8% to 3.4% on Subsidized Stafford Loans made during AY2012-2013. Figures are shown for the estimated average loan amount and the maximum amounts that undergraduate students may borrow based on their class level.

Table 2. Estimated Savings from an Interest Rate Reduction from 6.8% to 3.4%

One-year reduction for Subsidized Stafford Loans to undergraduate students

	Average Loan (FY2013)[a]	Max. Loan 1st year Undergraduate	Max. Loan 2nd year Undergraduate	Max. Loan 3rd year or Higher Undergraduate
6.8% Subsidized Stafford Loan				
Amount borrowed	$3,385	$3,500	$4,500	$5,500
Interest during grace period[b]	$115	$119	$153	$187
Balance at start of repayment	$3,500	$3,619	$4,653	$5,687
Total interest[c]	$1,448	$1,498	$1,926	$2,354
Total principal and interest	$4,833	$4,998	$6,426	$7,854
Monthly payment[c]	$40	$42	$54	$65
3.4% Subsidized Stafford Loan				
Amount borrowed	$3,385	$3,500	$4,500	$5,500
Interest during grace period[b]	$58	$60	$77	$94
Balance at start of repayment	$3,443	$3,560	$4,577	$5,594
Total interest[c]	$681	$704	$905	$1,106
Total principal and interest	$4,066	$4,204	$5,405	$6,606
Monthly payment[c]	$34	$35	$45	$55

[17] U.S. Department of Education, "President Obama Calls on Congress to Prevent Student Loan Interest Rates from Doubling," The Official Blog of the U.S. Department of Education, April 21, 2012, http://www.ed.gov/blog/2012/04/president-obama-calls-on-congress-to-prevent-student-loan-interest-rates-from-doubling/.

[18] Estimated average Subsidized Stafford Loan to undergraduate students for FY2013; U.S. Department of Education, *FY 2013 Department of Education Justifications of Appropriation Estimates to the Congress*, "Student Loans Overview," p. R-21.

	Average Loan (FY2013)[a]	Max. Loan 1st year Undergraduate	Max. Loan 2nd year Undergraduate	Max. Loan 3rd year or Higher Undergraduate
Estimated Savings				
Difference in total interest[c]	-$768	-$794	-$1,021	-$1,248
Difference in monthly payment[c]	-$6	-$7	-$9	-$10

Source: CRS analysis.

Notes: Values are not discounted to reflect the time value of money.

a. Estimated average Subsidized Stafford Loan to undergraduate students for FY2013. U.S. Department of Education, FY 2013 Department of Education Justifications of Appropriation Estimates to the Congress, "Student Loans Overview," p. R-21.

b. Interest accrues during the grace period on all Subsidized Stafford Loans disbursed between July 1, 2012, and June 30, 2014.

c. The minimum monthly payment according to a standard repayment plan is $50, which may result in a loan being repaid in less than 10 years. However, most borrowers obtain more than one loan resulting in the combined repayment amount being more than $50 and sufficient to result in a full 10-year amortization. For purposes of comparison, these figures are all based on a full 10-year amortization.

On the estimated average loan amount of $3,385, a reduction in the interest rate from 6.8% to 3.4% would result in savings of approximately $768 in total interest paid on a loan repaid according to a standard 10-year repayment plan. This would amount to savings of approximately $6 per month. For a student who borrows $5,500, the maximum amount that a student in the third year of undergraduate study or beyond could borrow, the interest rate reduction would result in savings of approximately $1,248 in total interest paid, and approximately $10 per month.

Who Borrows Subsidized Stafford Loans?

In AY2010-2011, 7.56 million undergraduate students borrowed Subsidized Stafford Loans.[19] The Obama Administration estimates that 7.4 million undergraduate students will borrow Subsidized Stafford Loans in AY2012-2013. The most recent data showing demographic characteristics of borrowers are from a U.S. Department of Education survey conducted during AY2007-2008.

Data from the 2008 National Postsecondary Student Aid Study (NPSAS:08) showing the distribution of Subsidized Stafford Loan borrowers by 2006 total income, for AY2007-2008, are presented in **Table 2**. The table also shows average EFCs and average amounts borrowed for borrowers in selected income bands. Data are presented separately according to income bands for undergraduate dependent students and undergraduate independent students.[20] Borrowers are divided approximately equally between the two categories of students. For undergraduate dependent students, income bands are based only on the total income of a student's parents. For undergraduate independent students and graduate students, income bands are based on the total income of the student and, if married, the income of the student and the student's spouse.

[19] U.S. Department of Education, unpublished data on AY2010-2011 Direct Loan Volume by Academic Level.

[20] For information on how student dependency status is determined, 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.

Distribution by Total Income

Borrowers of Subsidized Student Loans come from low-income families as well as from mid- and upper-income families. When considering dependent students, just over one-quarter of Subsidized Stafford Loan borrowers in AY2007-2008 were from families with total incomes of less than $30,000; and nearly half were from families with total incomes of less than $50,000. However, slightly more than half of borrowers were from families with total incomes of $50,000 or more; with one-eighth being from families with total incomes of $100,000 or more. For independent students, incomes tend to be lower and borrowing was concentrated among those with incomes between $10,000 and $50,000.

Table 3. Distribution of Subsidized Stafford Loan Borrowers by 2006 Total Income: AY2007-2008

Average EFCs and average amounts borrowed, by type of borrower

	Undergraduate Student Borrowers		
Income Band (2006)	**Percent in Income Band**	**Average Expected Family Contribution**	**Average Amount Borrowed in AY2007-2008**
Dependent students			
$100,000 or more	12.5%	$19,223	$3,291
$80,000 to $99,999	11.1%	$13,472	$3,341
$70,000 to $79,999	7.9%	$10,812	$3,359
$60,000 to $69,999	8.9%	$8,613	$3,453
$50,000 to $59,999	10.9%	$5,984	$3,551
$40,000 to $49,999	10.7%	$4,248	$3,597
$30,000 to $39,999	11.8%	$2,637	$3,624
$20,000 to $29,999	12.0%	$1,241	$3,512
$10,000 to $19,999	7.9%	$446	$3,493
Less than $10,000	6.4%	$199	$3,394
Total	100.0%	$7,117	$3,466
Independent students			
$50,000 or more	11.3%	$11,810	$3,111
$30,000 to $49,999	19.7%	$4,531	$3,321
$20,000 to $29,999	17.4%	$2,977	$3,238
$10,000 to $19,999	22.7%	$1,491	$3,231
$5,000 to $9,999	13.3%	$228	$3,279
Less than $5,000	15.7%	$31	$3,269
Total	100.0%	$3,112	$3,249

Source: CRS analysis of U.S. Department of Education, National Center for Education Statistics, National Postsecondary Student Aid Study, 2007-2008, (NPSAS:08) data.

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