Time for a Refi?

By Kristin Baird Rattini

Refinancing a student loan may be a good idea—as long as you understand what you might gain and lose.

If you have a student loan, you probably also have an inbox full of emails and a growing pile of snail mail offers suggesting you refinance that loan. Their appeal seems simple enough: By refinancing, you can ease the financial burden of a loan. Who wouldn't want that?

But proceed with caution, and do your homework before taking action. The decision to refinance depends on several factors: your ultimate goals, what you may give up, the true costs and savings, and the difference in terms among lenders. Here's a brief study guide to help you with the process.

Set Your Goal

"You need to start by asking, 'Why do I want to refinance? What is my goal?'" says Debra Chromy, president of the Education Finance Council. For most people, refinancing is considered to achieve one or more of these goals:

- Lower the interest rate.
- Lower the monthly payment.
- Keep the same monthly payment but repay the loan more quickly.
- Consolidate multiple loans into one loan.
- Switch from a variable to a fixed interest rate.

"Once you figure out what you're trying to accomplish, it will be easier to narrow down your refinance options," Chromy says.

Weigh the Benefits of Federal Loans

There are two types of student loans: federal and private. The federal government provides federal loans, while private loans are offered by lenders such as banks, credit unions, state agencies or schools. Both types of loans can be refinanced, at which point they become private loans.

However, there's a potential catch. "Federal loans come with a number of benefits that are lost if you refinance," says Susan Farrell, vice president of curriculum design for Thrivent Student Resources.

Federal loans offer deferment, which postpones repayment while you are in school, in the military or unemployed. Individuals in certain professions—such as teachers in low-income schools or nonprofit or government employees—may be able to have their federal loans forgiven after a certain number of years. Federal loans also offer eight different repayment plans, including a few that cap your payments at a certain percentage of your income, which is helpful if your income is low.

"If you think you might need to use these benefits, then refinancing may not be the right option for you," Farrell says.

Do the Math

If you won't need the benefits of your federal loan or if you only have a private loan, then the decision to refinance usually hinges on whether you will save money.

The terms of a refinance will depend on your income and credit score, a three-digit number based on your bill payment, debt and credit history. Lenders use those numbers to determine if you qualify for a loan on your own—without a co-signer—and what interest rate and term (length of repayment) to offer you.

"You only want to refinance if you can save money on the interest rate," Farrell says. In general, lenders offer lower interest rates for shorter-term loans, such as three years.

However, some people extend their payments over a longer term (10 to 15 years) because this lowers their monthly payment and helps with immediate cash flow. "You need to do the math," Chromy says. "By spreading out the loan over a longer period of time, your actual overall loan costs might be higher and may end up costing more than your original loan."

However, if you want to reduce both your monthly and long-term costs, there is a solution. "If you go with a longer-term loan, you can make extra payments toward the loan's principal when you have additional funds, to pay it off ahead of schedule," Farrell says.

Comparison Shop

Not all refinance loans are created equal—there are factors beyond the interest rate and term to consider. Shop around and ask tough questions to find the best deal: Do lenders offer a discount if you set up automated payments or establish a bank account with them? Do they offer hardship deferments? Will they release a co-signer after a certain number of payments? Will the lender forgive the debt obligation for the co-signer in the event of the borrower's death?

If the refinance terms you're offered aren't competitive, put off taking action. Work on improving your credit score and apply again in six to 12 months. "It's worthwhile to dip your toe in the finance waters to see what kind of loan you're eligible for," Chromy says. "If you can decrease your interest rate and the cost of your loan, then the effort could pay off." ■

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REFINANCING VS. CONSOLIDATION

Many families don't realize that refinancing and consolidating of loans are different. Refinancing is creating a new loan to pay off the loan balance of an existing loan. Borrowers refinance to save money on interest. The market and creditworthiness of the borrower determine the interest rate.

Federal loan consolidation rolls multiple direct student loans into a single loan. When you consolidate, your interest rate does not change—it's based on the weighted average of the original loans. In most cases, the term of the loan is extended, so you end up paying more over the life of the loan.

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REFI RESOURCES

Check out **ThriventStudentResources.com** for useful tools to help you navigate the student loan refinance process. Find helpful articles, access loan calculators, sign up for webinars and locate a Thrivent Scholars Advisor near you.