

INTEREST CAPITALIZATION ON FEDERAL STUDENT LOANS

Interest is the cost borrowers pay for a loan. It's calculated as a fixed percentage of the loan amount, (called the principal), and accumulates daily. Interest capitalization is when unpaid accumulated interest, also called **accrued interest**, is added to the principal loan balance. This increases the cost of the loan over time because interest is then calculated based on the new, higher loan balance. Depending on the repayment plan, capitalization may also cause a borrower's monthly payment amount to increase.

Fully eliminating this interest capitalization would limit the growth of loan balances for borrowers whose incomes are low for extended periods of time, as well as for borrowers who need to take a deferment or forbearance while in IDR because of unexpected life events or expenses. It also greatly simplifies IDR implementation and communication.

What Triggers Interest Capitalization?

Entering Repayment for the First Time. Borrowers are not required to make federal student loan payments while they're still enrolled in school at least half time, or for six months after they leave school. However, unsubsidized federal student loans will still accrue interest during these periods.

When a borrower starts repayment, all this accrued interest will capitalize — meaning it will be added to the principal balance — making the new loan balance higher.

Exiting Deferment or Forbearance. Interest is capitalized following periods of forbearance for both subsidized and unsubsidized loans (meaning, any interest that accrued while a borrower was in forbearance is added to the balance when the forbearance period ends).

Interest is capitalized following a deferment only for unsubsidized loans.

Exiting Certain Repayment Plans. Capitalization can also occur when a borrower exits certain income-driven repayment plans, either voluntarily or because they (1) failed to complete the annual income re-certification process or (2) their income became too high to remain enrolled in the certain income-restricted plans.

This is because, under IDR plans, a borrower's monthly payment may not fully cover all their accumulating interest. So, for those borrowers who are accruing unpaid interest, it will be capitalized if they exit certain plans.

Missing a Payment. Interest capitalization can also occur if a borrower misses a monthly payment.

Example: How Capitalization Affects a Borrower's Loan Balance

Here's an example of the cost of capitalization: You borrow \$30,000 to pay for college at a 3% interest rate. You complete your program in four years and then have a six-month grace period

before you start making payments on your student loan. By then, your loan has accumulated \$4,050 in interest.

If you had made monthly payments to cover that interest as it accrued, you would enter repayment with a balance of \$30,000. But if you made no payments, the \$4,050 in unpaid interest would be added to your principal loan balance, or capitalized, when you enter repayment. This means that going forward, your interest will be calculated based on a new, higher balance of \$34,050, rather than on the original principal balance of \$30,000.

For a standard 10-year repayment term, this means you would pay an additional \$4,693.20 over the life of the loan than if the interest had not been capitalized.

Further Reading

- [Understand how interest is calculated and what fees are associated with your federal student loan.](#)