Climbing Mt. Debt: Navigating your student loans and repayment options

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Abstract

Federal student debt is different from other types of debt. Traditional repayment strategies of paying more as quickly as possible can be contraindicated depending on your student debt balance and student debt-to-income ratio. The ability to pay using Federal Income-Driven Repayment (IDR) plans can greatly increase monthly cash flow and decrease total student loan repayment costs for most recent graduate veterinarians with student debt. The challenge is understanding the various repayment options available and matching an IDR strategy to each veterinarian's circumstances, which often includes student loan forgiveness and a tax liability due 20 to 25 years after starting repayment. Using objective measures for analyzing repayment options, as well as analyzing the rules and political landscape around Federal student loans, a borrower can create a student loan repayment treatment plan that can lead to increased financial flexibility and improved financial wellness.

Key words: student loans, student debt, federal income-driven repayment

Résumé

La dette fédérale étudiante diffère des autres types de dettes. Les stratégies traditionnelles de remboursement mettant l'accent sur l'acquittement le plus rapide possible peuvent être contre-indiquées selon la balance de votre dette étudiante et de votre ratio dette/revenu étudiant. La possibilité de payer en utilisant les plans fédéraux de remboursement en fonction du revenu peut augmenter considérablement les liquidités mensuelles et réduire les frais totaux de remboursement du prêt étudiant pour la plupart des vétérinaires nouvellement diplômés ayant une dette étudiante. Le défi est de comprendre les multiples options de remboursement disponibles et d'adopter la stratégie de remboursement en fonction du revenu adaptée à la situation de chaque vétérinaire. Ces circonstances incluent souvent la radiation de la dette étudiante et un assujettissement à l'impôt exigible 20 ou 25 ans après le début du remboursement. En utilisant des mesures objectives pour l'analyse des options de remboursement de même qu'en analysant les règles et le climat politique entourant les dettes étudiantes fédérales, un emprunteur peut créer un plan de remboursement de la dette étudiante qui va accroître la flexibilité financière et améliorer le bien-être financier.

Introduction

For 2017 veterinary school graduates, the median debt for those reporting student debt varies from about $150,000 to more than $300,000,[1] depending on the school and residency status of the graduate. The median salary for "Food Animal Exclusive" recent graduate veterinarians is between $70,000 and $93,000 for those 1 to 6 years in practice.[2]

With student debt-to-income ratios consistently greater than 1 for most recent graduate veterinarians,[1] repaying educational debt using traditional repayment strategies can be challenging. During the Climbing Mt. Debt session, we will discuss how to examine your student loans and assess the income-driven repayment options to help alleviate the financial stress created by traditional repayment plans. We will also explore strategies for treating the "side effects" of income-drive repayment, including the potential tax liability incurred from student loan forgiveness.

Please refer to the online presentation created for the 2019 AABP Recent Graduate Conference[7] if you wish to access the presentation material used during the live session.

Student Loan Repayment Case Study

Consider a food animal exclusive veterinary practitioner graduating in 2017 with a federal student debt balance of $150,000 at 5.7%, and an income of $70,000 living and working in Ohio.

A standard 10-year repayment plan monthly obligation would be about $1,643/month, or roughly 37% of her after-tax income for a single federal and state allowance in Ohio. Total loan repayment costs over 10 years would be about $197,136. Alternatively, this practitioner might consider using Pay as you Earn (PAYE), 1 of the federal income-driven repayment plans.[3] The minimum monthly payment due under PAYE is 10% of "discretionary income." Discretionary income is equal to taxable income minus 150% of poverty guidelines for the borrower's family size and state of residence.[4] In this case, the minimum monthly PAYE payment would be $432/month using a taxable income of $70,000 and a family size of 1. When/if her income decreases due to a move, job change, unpaid maternity leave, etc., her monthly payment under PAYE will decrease. Conversely, if her income increases as her experience increases, her monthly payment under PAYE will increase as well with the minimum payment due never more than the $1,643/month, the same as it would be under a standard 10-year plan. She will have 20 years to make payment based on her income using PAYE, and if there is any amount remaining after 240 monthly payments, the remainder is forgiven and treated as taxable income during the tax year in which forgiveness occurs.[6] To model the total repayment costs using PAYE including an estimate of the tax due on forgiven debt, enter income and family parameters in the VIN Foundation Student Loan Repayment Simulator.[9] Here is a sample simulation hyperlink for this case: Case Study AABP (Simulation).

The simulation inputs are derived from the median income for Food Animal Exclusive practitioners from the AVMA Veterinary Salary Estimator for Early Career Veterinarians,[2] then assumes a 3% increase in salary after the 6 years in practice. This case also assumes the practitioner is a family size of 1 for the duration of student loan repayment.

The simulation shows this veterinarian making monthly payments equal to $163,786 leaving $157,213 to be forgiven.[6] Assuming an average tax rate of 30% on the forgiven balance in 2037, this borrower would need $47,164 on hand to cover the additional tax liability due when she files her taxes. The Forgiveness Planning Module in the Simulation shows that she can plan for this tax due by saving $143/month in account(s) that yield at least 3% return on her plan over 20 years. This would yield a total loan repayment cost of $198,178 (total monthly payments plus the amount saved to cover the anticipated tax due on forgiveness).

Repaying using this PAYE strategy yields a similar total repayment costs as paying under a standard 10-year plan, but it provides much greater monthly cash flow flexibility and the ability to pay the loan over a longer period of time.

Generally, the higher the student debt balance and/or student-debt-to-income ratio, the more financially beneficial income-driven repayment plans will be for borrowers. However, higher student debt balances will likely result in higher tax liabilities due when balances are forgiven. Thus, it is imperative to consistently analyze your specific circumstances using tools available in the VIN Foundation Student Debt Center[9] to keep your student loan repayment plan on track, especially if you anticipate a tax due on forgiven student debt.

Steps For Understanding Your Student Loan Repayment Options and Costs

1) Visit the National Student Loan Data System (NSLDS).[5] Log in using the same credentials that you used to apply for your financial aid in school. Look for the "MyStudentData Download" button to save a copy of your NSLDS file (.txt format).
2) Visit the VIN Foundation Student Debt Center and look for the My Student Loans tool.[8] Upload your NSLDS file into the My Student Loans tool to get a summary of your federal student loan balance and an analysis of your income-driven repayment plan eligibility. There are several income-driven repayment plans available that will calculate your payment between 10 to 15% of your discretionary income.[4]
3) Simulate your repayment costs using the VIN Foundation Student Loan Repayment Simulator.[9] Because changes to your income, family size, and personal circumstances greatly impact your loan repayment costs, use a tool like the simulator to estimate your costs and compare against traditional repayment strategies. The Simulator will also help you plan for any anticipated tax liability incurred due to student loan forgiveness. When analyzing your simulation, you want to maximize your monthly cash flow and minimize your total student loan repayment costs. Generally, if you are paying more than 10 to 15% of your discretionary income towards your student loans each month, you are paying more than your income requires.
4) Apply for an income-driven repayment plan at studentloans.gov.[4] Remember to provide recertification of your income and family size at least yearly or sooner if your income decreases. Repeat steps 3) and 4) at least annually or when your circumstances change until your loan balance is zero or you reach student loan forgiveness. Adjust your repayment and savings plan accordingly.

Strategies for Navigating Income-driven Repayment

There are exceptions to many of the following statements, but here are some commonalities that have surfaced while working with thousands of veterinarians using income-driven repayment:

A) Not all borrowers and all loans qualify for all income-driven repayment plans. Utilize the VIN Foundation My Student Loans tool to determine your income-driven repayment eligibility. Generally, Pay as You Earn (PAYE) is a better plan than Revised PAYE (REPAYE), which are better plans than Income-Based Repayment (IBR).
B) The most common mistakes made by borrowers are choosing the wrong repayment plan, using deferment/forbearance instead of IDR, and not renewing their required annual income documentation each year while using income-driven repayment. You MUST provide timely documentation of your taxable income each year prior to the anniversary date for your income-driven repayment plan. If you do not provide the documentation or your loan

servicer does not process your documentation on time, unpaid interest will be capitalized which can significantly add to your total loan repayment costs.

C) If your repayment simulations show a student loan balance that will be forgiven, it is always less expensive to pay the minimum based on your income and plan for the eventual tax due on forgiven amounts.

D) Student debt is not the same as other types of debt. Paying your student debt as fast as possible with as much income as you have available is often not the cheapest nor the fastest way to reaching a student loan balance of zero. You do not have to pay more than your income requires towards your student loans. Allowing your income to determine your monthly student loan payment often provides more cash flow flexibility and the ability to have a more comprehensive financial wellness plan.

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