

# 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 time-driven repayment strategies of paying as much as you can as quickly as possible may be contraindicated, depending on your student debt balance and student debt-to-income ratio. The ability to repay 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. This was true before COVID-19, but has been emphasized during the pandemic with the bonus interest and payment suspension applied to federally held student loans. The challenge is understanding the various loan types, repayment options available, and choosing an IDR strategy appropriate for each veterinarian's circumstances. This 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 knowing 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 debt, finances, loan repayment

## Introduction

For 2018 veterinary school graduates, the median debt across all new graduates varies from about \$75,000 to more than \$320,000, depending on the school and residency status of the graduate. The mean debt of only those graduates who finished veterinary school with student debt was about \$184,000.<sup>1</sup> The median salary for "Food Animal Exclusive" recent graduate veterinarians located in Kentucky is between \$71,500 and \$95,000 for those 1 to 6 years in practice.<sup>2</sup>

With student debt-to-income ratios consistently greater than one for most recent graduate veterinarians,<sup>1</sup> repaying educational debt using traditional repayment strategies can be challenging. During the Climbing Mt. Debt sessions, we will discuss how to examine your student loans, understand the interest and payment relief provided by Congress and the President in 2020 due to the pandemic, and assess the IDR options to help alleviate the financial stress created by traditional repayment plans. We will also explore strategies for treating

the "side effects" of income-driven repayment, including the potential tax liability incurred from student loan forgiveness. And in the second session, we will cover financial health and wealth building strategies while managing and repaying your student loans. Please refer to the online presentation created for the 2020 AABP Conference<sup>7</sup> if you wish to access the presentation material used during the live session.

## Student Loan Repayment Case Study

Consider a food animal exclusive veterinarian graduating in 2018 with a current federal student debt balance of \$184,000 at 5.75% interest and a current income of \$85,000 living and working in Kentucky, equating to a student debt to income ratio of 2.2. A standard 10-year repayment plan monthly obligation would be about \$2,020/month, or roughly 39% of her after-tax income for a single federal allowance in Kentucky with no pre-tax deductions. Total loan repayment costs over 10 years would be about \$242,370. Alternatively, this practitioner might consider using Pay As You Earn (PAYE), 1 of the federal IDR plans.<sup>3</sup> The minimum monthly payment due under PAYE is 10% of "discretionary income." Discretionary income is equal to taxable income minus 150 percent of poverty guidelines for the borrower's family size and state of residence.<sup>4</sup> In this case, the minimum monthly PAYE payment would be \$549/month for a taxable income of \$85,000 and a family size of one. 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. However, the minimum payment will never be more than the \$2,020/month it would be under a standard 10-year plan when/if her taxable income exceeds about \$260,000 per year. She will have 20 years to make payments 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.<sup>6</sup> To project 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.<sup>9</sup> Here is a sample simulation for this case: Case Study AABP (Simulation).

The Simulation income input starts with her current \$85,000 of taxable income, then assumes a 3.5% increase in

per year. This case also assumes the practitioner is a family size of one for the duration of repayment. The Simulation shows this veterinarian making total PAYE monthly payments of \$190,179 leaving \$201,012 to be forgiven.<sup>6</sup> Assuming an average tax rate of 30% on the forgiven balance in 2038, this veterinarian would need \$60,303 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 \$183/month in account(s) that yield at least 3% return per year on her forgiveness savings plan over 20 years. The total loan repayment cost for this strategy is \$234,153 (total monthly payments plus the amount saved to cover the anticipated tax due on forgiveness). This PAYE strategy lowers her total repayment costs vs. paying under a standard 10-year plan, but more importantly, it provides much greater monthly cash flow flexibility and the ability to pay the loan over a longer period of time.

Generally speaking, when a student-debt-to-income ratio is greater than one, IDR plans will be more financially beneficial for borrowers. However, higher student debt balances will likely result in higher tax liabilities due when balances are forgiven. Thus, it is imperative to analyze your specific circumstances using tools available in the VIN Foundation Student Debt Center<sup>9</sup> 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 Federal Student Aid website.<sup>5</sup> Log in using the same credentials that you used to apply for your financial aid in school. On your dashboard, locate and click the “View Details” link. On your “My Aid” page you will see the “Download My Aid Data” link. Clicking this link will download your “MyStudent-Data.txt” file to your computer.
- 2) Visit the VIN Foundation Student Debt Center and look for the My Student Loans tool.<sup>8</sup> Upload your student aid data file to get a summary of your federal student loan balance, the loans eligible for the pandemic interest and payment suspension, and an analysis of your IDR plan eligibility. There are several IDR plans available that will calculate your payment between 10 to 15% of your discretionary income.<sup>4</sup>
- 3) Simulate your repayment costs using the VIN Foundation Student Loan Repayment Simulator.<sup>9</sup> Because changes to your income, family size, tax filing status, 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 takes into account the current pandemic interest and payment suspension and 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 to help improve your financial wellness and minimize your 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 IDR plan in your studentaid.gov portal under the “Manage Loans” menu option.<sup>4</sup> The easiest way to apply is electronically and pulling in your most recent Adjusted Gross Income (AGI) from a recent tax return via the IRS Data Retrieval Tool. Once approved, 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 result in a decrease in your income or increase in your family size 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 common themes learned from working with thousands of veterinarians with student loans:

- Not all borrowers and all loans qualify for all IDR plans. Utilize the VIN Foundation My Student Loans tool and Income-Driven Repayment Eligibility feature to see the plans you are able to use. This feature also helps you understand which loans are eligible for the pandemic interest and payment suspension. Generally, Pay as You Earn (PAYE) is a better plan than Revised PAYE (REPAYE), which are better plans than Income-Based Repayment (IBR).
- The most common mistakes made by borrowers are: i) choosing the wrong repayment plan, ii) paying more than their income requires, iii) using deferment/forbearance instead of IDR, and iv) not renewing their required annual income documentation each year while using IDR. You MUST provide timely documentation of your taxable income each year prior to the anniversary date for your IDR plan. If you do not provide the documentation or your loan servicer does not process your documentation on time, unpaid interest will be capitalized and your monthly payment will revert to the standard 10-year plan payment, which can significantly add to your total loan repayment costs.
- If your repayment simulations project a balance forgiven, it is always less expensive to pay the minimum based on your income and plan for the eventual tax due on forgiven amounts. This applies to the pandemic interest and payment suspension as well. Since you receive credit towards forgiveness

during the suspension, use this bonus student loan relief time to jump-start other areas of your financial wellness. Watch for more information from your loan servicer to see when you need to restart repayment after December 31, 2020, or to provide additional income documentation.

- 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 taxable 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.

### Acknowledgement

The authors declare no conflict of interest.

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