Medical Economics
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Say goodbye to your med school debt

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Solvency may be closer than you think. These strategies worked; they might do the trick for you, too.

By Doreen Mangan, Senior Editor

When we spoke to FP Suzanne L. Hawkins in 1993, she was half seriously hoping a lucky lottery ticket might wipe out the $103,000 she still owed for her medical education. That didn't happen, but her debt is now minuscule--less than $10,000--thanks to a US government loan-repayment program.

Hawkins is fortunate. Not all young doctors can shrug off their loans that fast. Since Hawkins left medical school, debt management for young physicians has become more complex.

The average medical school debt has climbed 6 percent or more annually in recent years. The mean debt for 1999 graduates, including college debt, was nearly $91,000, compared with about $60,000 in 1993. At the same time, residents' stipends have been growing only 2 percent annually. This year's average is about $35,000, according to the Association of American Medical Colleges.

Moreover, some loans that once could be deferred for two years during residency no longer offer that benefit. That's especially tough for young doctors who, already strapped, may have to start repayment during their training, unless they can get a hardship deferment. And while more practices are dangling the debt-forgiveness carrot to lure young doctors, they're still in the minority.

On the bright side, loan-repayment and consolidation options have increased. Programs such as the one offered by the National Health Service Corps have upped their benefits. And, since last year, borrowers have been allowed to take tax deductions for part of their school-loan interest.

Here are some strategies to help you achieve solvency:

Maximize deferments, explore forbearance

In what appears to have been a misguided attempt at simplification, Congress tried to combine 14 educational loan deferments into three or four. The option to defer repayment until after a two-year residency--once part of several government loan deals for medical students, including the federal Perkins and Guaranteed Student Loan programs--got lost in the shuffle, according to Paul S. Garrard, director of student financial services for the Association of American Medical Colleges. The current crop of second-year residents was the first to feel the impact of that, when they applied for deferment in the fall of 1997.

Deferment is still available for some education debt, such as Health Education Assistance Loans (HEALs). Those who received Stafford loans before 1993 and those who can prove economic hardship can also defer repayment. However, even then, interest continues to accumulate on unsubsidized loans.

The same interest dilemma applies to debts in forbearance, which is available for all medical education loans. This allows you to postpone paying the loan even after it's due. Financial planners recommend forbearance only when you lack other viable options. You can apply for forbearance of a federal education loan any time in your career. It's usually granted for hardship situations, disability, unemployment, or additional training.

Whether you're in deferment or forbearance, you should at least make interest payments. If you let interest accumulate, it will be added to the amount of the loan, and it could eventually double what you owe. Chipping away at the interest will reduce your future debt.

If you can't pay all of the interest you owe, pay it on the loans with the highest interest rates. The tax deduction you can claim on educational loans will lessen the sting, at least for residents who are already repaying their school debts. It's unlikely that doctors already in practice can qualify, because of income ceilings. To be eligible, a single taxpayer must earn less than $55,000, and a couple less than $75,000. And the borrower can't take a deduction for payments made while the loan is in deferment.

If you qualify, though, you can deduct a portion of the interest during each of the loan's first five years. The maximum write-off for 1998, when this deduction took effect, was $1,000. It rises each year until 2001, when it will be capped at $2,500.

Bet the house on your future

Given the miserly benefit of the educational-loan interest deduction, some financial planners say you may be better off getting rid of those loans using home equity. Married homeowner couples who file jointly can deduct all of the interest on up to $100,000 of home-equity debt. For singles and marrieds who file separately, the per-person limit is $50,000.

Brian Hensen, a financial planner in Madison, WI, urges young doctor clients to go the home-equity route. "Many people overlook the opportunity to clear up loans by borrowing on their houses and deducting the interest," he says.

If your home is worth $200,000, for example, and you've paid down $50,000 of that, you might be able to borrow, say, $50,000 at 7 1/2 to 9 percent, and deduct all the interest. However, generally you must pay back home-equity loans within five to 15 years, Hensen says, while you can stretch out consolidated loans much longer.

Ease the pain with consolidation

If you're staring at loans from many lenders, with varying balances, interest rates, and due dates, consider a consolidation loan. This pays off existing debts and bundles them into a new loan. It will simplify your life, by eliminating most of the paperwork. And to make monthly installments more affordable, you can repay a consolidation loan over 25 or 30 years.

"Consolidating can make as much sense emotionally as financially," says Todd Bramson, a Madison, WI, financial planner. Bramson, however, frowns on consolidation if a borrower's goal is just freeing up cash for luxuries he or she can't yet pay for out of cash flow.

Consolidation loans are available from the federal government, through Sallie Mae, banks, and other lenders. The terms don't vary much. The federally mandated interest rate for educational consolidation loans is the same for all lenders. It's based on a weighted average of the loans being bundled, and rounded up to the next highest one-eighth of 1 percent. This rate won't be above 8.25 percent, and it's fixed for the life of the loan.

Be careful if you're consolidating HEALs with other types of loans, however. In some types of consolidations, HEAL rates aren't figured into the weighted average calculation. So if your HEALs have lower rates than the other loans in the consolidation, you could lose the benefit of those lower rates. On the other hand, if your HEALs have higher rates than the other loans, you'd benefit by not having the HEALs factored in. Ask your loan officer how HEALs would be treated in the consolidation loan you're considering.

If you have several low-rate HEALS, you may benefit more by consolidating those separately, through a HEAL Refinancing. The rate will differ from lender to lender, but it will be variable and tied to the 91-day Treasury T-bill.

Consolidation can help you reduce the amount you pay over time if you're holding loans above the federally mandated rate, and *if* you pay off the consolidation loan in the original time frame. If you extend the repayment period, you could end up shelling out more interest.

Loan consolidators offer attractive terms. For example, it's possible to arrange for a graduated payment schedule, increasing monthly payments as your income rises. And you can make penalty-free prepayments. That's how Indianapolis anesthesiologist Michael A. Kellams is retiring a 20-year loan in 10 years, saving himself an enormous amount of interest (see "Loan Consolidation and a high salary chop down debt fast"). Your consolidation can even include a loan that's in default.

In addition to a consolidation's terms, carefully consider timing issues. In some cases, you'll lose deferment and forbearance provisions on the bundled loans. Primary care doctors can't defer payment on consolidated HEAL loans for six or seven years, for instance.

AAMC's Paul Garrard suggests that, before you consolidate your loans, you ask questions such as:

- What will happen to the status of my student loans if they're in deferment or forbearance when I apply for a consolidation loan?
- What will the monthly payment be, as well as the total repayment amount of the consolidation loan?
- How will early payments be applied?
- Which of my loans can I consolidate?
- Will I pay fees or hidden costs when I consolidate?

And New York City financial planner Lawrence Keller offers this caveat: Although lenders will consolidate spouses' student loans into one repayment package, that's generally a bad idea. "If one spouse dies or becomes disabled, the other will still be responsible for payment of the entire loan," he says. Furthermore, the couple must agree to repay the consolidation loan regardless of any change in marital status. So if you separate or divorce, you'll still be linked, no doubt unhappily, for the life of your loan. In contrast, if you and your spouse consolidate your loans individually and one of you dies, that spouse's consolidation loan will be taken off the books.

Share the burden with Uncle Sam or your state

If you're willing to be flexible about where you work, you have an altruistic streak, and you're adventurous, you could participate in a government-run loan-repayment program. The National Health Service Corps, for example, offers loan-repayment incentives for primary care physicians willing to work in medically underserved areas. In addition to the salary and benefits, you can get up to $50,000 in government and commercial loans repaid if you make a two-year commitment--more if you sign on for a longer term.

Of course, you could probably earn more in private practice and, if you have the discipline, use all of those extra funds to pay off your loans. However, as an enticement to serve in the NHSC, Uncle Sam kicks in an additional 39 percent of the loan-repayment money. That's to cover taxes, since the repayment is considered taxable income. Not a bad deal, as long as you enjoy the experience.

One obvious drawback is that if you don't like where you're sent, you're stuck. The opposite can happen, though: Suzanne Hawkins (see "The lottery failed this doctor, but Uncle Sam came through") has stayed on at her clinic in Holland, MI, long after she fulfilled her obligation to the program. She has family nearby, and she enjoys her patient population, mostly migrant workers. "They're very nice people, very appreciative and compliant," she says. "I can see myself making a difference."

Another public-service option is the Indian Health Service Loan Repayment Program. The IHS serves about 1.5 million American Indians and Alaska natives who belong to more than 557 federally recognized tribes in 34 states. You'll earn about $70,000 plus benefits, and get up to $20,000 a year toward your loans, for a minimum two-year commitment. You can stay in the program until your entire debt is wiped out. Plus, the IHS will pay up to 31 percent of the federal taxes due on the loan repayment.

Various branches of the military offer scholarships to medical students in exchange for service after their training. That's how Gary C. Edelman dealt with his medical school expenses. Today, three years after he wound up his service, Edelman calls it a pretty good deal .

If you're already an established physician with a liking for the military, and you can spare at least one weekend per month for service, consider the reserves. Both the US Navy and Army offer loan repayment of up to $20,000.

Not to be outdone by the federal government, many states offer loan-repayment programs for clinicians who will work in poorly served areas . The US government, in fact, bolsters the repayment budgets of 36 states, dollar for dollar, with up to $6 million a year. That money, though, must be spent in federally designated Health Professional Shortage Areas.

The loan-repayment program in Washington state has grown to be "a significant recruitment strategy here," says Kathy McVay, program administrator in Olympia. Since its 1990 inception, the program has lured 38 doctors to rural practices. The amount available for disbursement has grown from $200,000 in the 1991-93 biennium to $1.5 million this year. The funds are available for all health care professionals, including physician assistants, dentists, and others. Washington receives $100,000 annually in matching dollars from the federal program.

Since Uncle Sam's matching dollars started flowing in 1988, states that benefited from federal largesse have recruited 1,041 mostly primary care doctors and 1,577 other health professionals. The states' payments vary, but $20,000 to $25,000 in loan reductions per year is common. The minimum commitment is usually two or three years, with optional longer stays.

Find a practice that desperately needs you

Some practices and hospitals use bonuses to entice debt-laden doctors. Others help pay off loans of doctors they hire. Such attractive deals may be getting scarcer for primary care physicians. "The residency programs did such a good job of drawing doctors to the primary care specialties that demand is not as strong as it was one or two years ago," explains Steve Schoen of the Miami recruiting firm MDR Associates. "And there's an upswing in demand for internal-medicine and surgical subspecialties."

Ironically, though, primary care doctors have the most interest in debt-reduction spots. "The specialists know they can generate enough income to take care of their obligations," Schoen says. "Primary care docs know they'll never earn as much as some specialists, so they're looking for an edge in whittling down their loans."

So, if you're a primary care doctor hoping to find a practice to take over your debt, you may have to go far from the bright city lights. Schoen suggests you consider rural communities in the Midwest, noncoastal regions of the South, western Texas, and some parts of the Northeast, such as small towns in New York state that border Canada.

Wherever you land, make it somewhere you're likely to enjoy for the long term, because you'll probably have to sign on for about 10 years. "If you decide you don't like it after a year or two, you could feel pretty trapped," Schoen says.

How four young doctors banished medical school debt

When we talked to young doctors who were struggling with debt six years ago, their frustration, and even despair, was palpable. However, when we checked in with four of them recently, we found them in good financial shape. They had either partly or fully paid down their debts. They were enjoying medicine and life, their money worries long forgotten. Here's how they got their heads above water.

The lottery failed this doctor, but Uncle Sam came through

FP Suzanne L. Hawkins (below), the lottery ticket buyer in the accompanying story, cheerfully admits that her biggest win was $100. So much for an instant solution to her debt. Hawkins incurred about $80,000 in HEAL loans during her DO training. Interest started from Day One of each loan. By the time she finished her three-year residency, her total debt had grown to $140,000, and financial freedom was nowhere in sight.

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Hawkins chose to work off the debt in the National Health Service Corps' loan-repayment program, and was assigned to a public clinic in Holland, MI, in 1990. Besides her salary, she received about $20,000 toward her loans annually for four years. Then she extended her contract for two more years and received $35,000 annually toward the loans.

When we talked to her in 1993, she owed $103,000, even though she'd paid more than $83,000--mostly in interest--over the prior three and a half years. Interest was still mounting, to the tune of $635 a month.

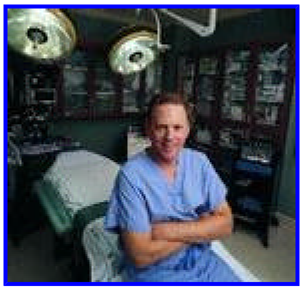
By 1996, Hawkins' debt had been reduced by $150,000 in all. She's now paying less than $200 a month on the balance, which is less than $10,000.

In 1995, Hawkins was able to fulfill her dream of buying a house. Her attempts to do that a few years earlier had been futile. "Bankers laughed when they heard about my loans," she recalls. This doctor now owns a modest three-bedroom split-level house that she purchased for less than $150,000, with only 5 percent down.

Would she recommend the NHSC route to other young doctors with heavy debt? Possibly, now that the program has improved somewhat. Previously, the federal money was distributed quarterly, but interest accrued monthly, so doctors couldn't reduce their loans as fast as they could with timelier payments. Now, NHSC doctors can get their federal loan money in annual lump sums, so it's easier to melt down what's owed.

Hawkins notes one drawback about her years at the public clinic: "I could have been in private practice all that time, and made more money, and been vested in a retirement plan," she says. Although the NHSC loan-repayment plan offers some benefits, there is no pension plan.

The military solution: paying with time instead of money



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Some people join the Navy to see the world. Gary C. Edelman (above) joined so the Navy would pay for most of his medical education. Overwhelmed by the prospect of borrowing at least $22,000 annually to fund four years at Dartmouth Medical School, Edelman applied for and won a Navy scholarship during his first year at the Hanover, NH, school.

The scholarship covered tuition, fees, books, health insurance, and a monthly stipend for living expenses. Edelman borrowed only $17,000, for other costs. When his five-year residency in general surgery ended in 1993, he became a lieutenant commander in a US Naval hospital in Millington, TN, and repaid the Navy with three years of service.

Does he regret those years? Not one bit. "By the time I left, in 1996, my salary was $96,000," says Edelman. "I was able to bank every other paycheck." That gave him an early start on retirement savings, which now total $240,000. Not bad for a single 37-year-old.

The major drawback, Edelman found, was that because so much of medical care for military employees is farmed out to civilians, his surgical experience in the Navy was limited. "I did a lot of hernias and gallbladders," he says. "I didn't get complicated cases. If you're a surgeon and you want to do a couple of big cases a month, you won't get that in the military."

Besides scholarships, the military also offers post-residency loan-repayment programs. A doctor who's thinking of joining the military to wipe out a debt should talk to physicians at the nearest military base, advises Edelman, who is now a general surgeon in private practice in Tucker, GA. "Ask them the tough questions," he urges. "Are you happy with your professional status? What do you do?"

"Being in the military is a good way to save money, but there is a professional cost," he concludes.

A repayment offer this doctor couldn't turn down

"We'd like to take a nice vacation once in a while," Susan M. Szabo (below) said wistfully when we talked with her in 1993. The Oshkosh, WI, pediatrician had consolidated 21 loans in 1988 and was feeling the burden of $1,300 monthly payments--one third of her income, equal to the mortgage payments she and her husband were making. A manager in retailing, her spouse was earning $40,000.

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Szabo had reduced the $145,000 loan to $138,000 in five years. The payback period stretched ahead for 25 more years. She was making two prepayments annually, hoping to knock about 10 years off that. "My daughter, who's 6, would have been a junior in college by the time the loan was paid off," she said.

But in 1994, another practice recruited her, with the promise of paying $9,200 a year on her loan for 15 years. The catch, of course, is that Szabo can't leave during that time. And she pays $4,000 a year in income tax on what the practice pays toward the loan. Still, this benefit has enabled her to save money for her two children's education and take some of those vacations she'd wanted.

Szabo feels fortunate in her position. Not only is she enjoying pediatric medicine, but, she says, "not many practices seem to be offering loan repayment anymore."

Loan consolidation and a high salary chop down debt fast

As Michael A. Kellams (below) began an anesthesiology residency in 1993, he worried that health care reforms might limit his earning potential. With $130,000 in loans and interest mounting, he'd been counting on a high salary to bail him out. Anxiety was his constant companion. "Rarely a day goes by that I don't think about my school debt and wonder if I'll be able to pay it off," he told us then.

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But his story has a happy ending. In 1996, he joined a 56-doctor anesthesiology service in Indianapolis. Although the practice participates in managed care plans, it negotiates keenly for favorable reimbursements and also has fee-for-service patients. As a result, Kellams, 33, earns $350,000 a year and is well on his way to vaporizing the debt, which, with interest, had climbed to $170,000.

After residency, he consolidated about 18 loans that had interest rates from 7 1/2 to 9 1/2 percent, and now he has one 30-year Sallie Mae loan. By using an automated payment plan for his $1,400 monthly installments, he shaved half a percentage point off the interest, which brought his rate to 7 1/8 percent. And because he's paying an extra $1,400 a month, Kellams expects to completely retire the loan by 2005. "It has worked out really well," he says. "I don't even think about the debt anymore. It's just another bill to me."

States extend helping hands to doctors

The 36 states listed below offer loan-repayment programs, mainly to primary care doctors who agree to practice in areas of need. Almost all of these states get matching federal dollars to assist public clinics or private nonprofit practices. Uncle Sam's funds are not available for doctors going into private practice. However, some states will make grants of their own money to private-practice doctors in underserved areas.

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How to find help

Loan consolidation and debt management advice

Association of American Medical Colleges
202-828-0400
www.aamc.org/stuapps/finaid/start.htm

US Department of Education's Consolidation Department
800-557-7392
www.ed.gov/offices/OPE/DirectLoan/consolid.html

Sallie Mae
888-272-5543
www.salliemae.com/loans

Loan-repayment programs

Air National Guard Student Loan Repayment Program
301-836-8677
hafnera@ang.af.mil.

Army National Guard and Army Reserves Student Loan Repayment Programs

See the service representative in your area.

Indian Health Service
301-443-3396
www.ihs.gov

National Health Service Corps
800-221-9393
www.bphc.hrsa.dhhs.gov/nhsc

. Say goodbye to your med school debt. *Medical Economics* 1999;23:38.