

# Medical Student Section Issue Brief: Income Based Repayment

The information contained in this Issue Brief is based on the Final Rule for 34 CFR Parts 674, 682, and 685, published in the Federal Register on Oct. 23, 2008, and is subject to change. Please consult your lender and a financial planning expert before making any decisions about loan repayment.

## Background

In September 2007, the College Cost Reduction and Access Act of 2007 (CCRAA) was signed into law. CCRAA eliminated a form of economic hardship deferment known popularly as the "20/220 pathway" and replaced it with an Income Based Repayment plan (IBR). IBR will go into effect on July 1, 2009, after which time deferment under the old 20/220 pathway will no longer be available.

The 20/220 pathway provides for deferment of federal educational loans for up to three years for borrowers whose debt burden is greater than 20% of their income and whose income minus debt burden is less than 220% of Federal Poverty Level (FPL) for a family of two. The federal government pays any interest that accrues on subsidized loans during deferment, although interest on unsubsidized loans continues to accrue. Borrowers qualifying for deferment under 20/220 make no monthly loan payments.

Unlike 20/220, IBR is not a loan deferment program. Instead, IBR provides for reduced payments (i.e. partial deferment) for borrowers who demonstrate partial financial hardship. Only individuals earning less than 150% FPL (100% FPL = \$10,830 per year for an individual) are eligible for full deferment. Consequently, under IBR, unlike with 20/220, nearly all residents with student loans will be required to make monthly payments starting in their first year of residency.

## How IBR works

### Eligibility

Eligibility to repay loans under IBR depends on whether you demonstrate a "partial financial hardship," which exists when your monthly loan payment under a standard 10-year repayment plan<sup>1</sup> exceeds 15% of the difference between your adjusted gross income (AGI) as reported to the IRS and 150% FPL for your family size.<sup>2</sup> In concrete terms, a single resident earning \$45,659 per year (the national average<sup>3</sup>) is eligible for repayment under IBR if his or her total monthly loan payment exceeds \$368, which corresponds to a total debt burden of approximately \$32,000 at 6.8% interest. Most residents with student loans are likely eligible for repayment under IBR.

Only federally-guaranteed loans made through the Federal Family Education Loan (FFEL) or Direct Loan programs (e.g.

Stafford, GRAD Plus, and Federal Consolidation loans) are eligible for repayment under IBR. Private (nonfederal loans issued by lenders such as banks or credit unions), Parent PLUS, and Perkins loans cannot be repaid under IBR. If you have a combination of federally-guaranteed and other loans, the amount of non-federally-guaranteed debt is not included in calculations to determine eligibility to repay your federally-guaranteed loans under IBR.

### Calculating your monthly payment

As long as you are eligible for repayment under IBR, your loan principal is irrelevant. Monthly loan payments, which are recalculated every year you participate in IBR, depend on your AGI and on FPL for your family size.<sup>2</sup> Payments are capped at 15% of the amount by which your AGI exceeds 150% FPL:

$$\text{Monthly payment under IBR} = \frac{[\text{AGI} - (\text{FPL} \times 1.5)] \times .15}{12}$$

For example, for a single (FPL = \$10,830), first-year resident with a salary of \$45,659, the monthly loan payment under IBR is approximately \$368. Under a standard 10-year repayment plan, the same resident (with \$155,000 total debt – the national average<sup>4</sup>) would be required to make monthly payments of \$1,784. You can determine your monthly payment under IBR using the calculator at [www.IBRinfo.org](http://www.IBRinfo.org).

No matter how high your future income rises, your required monthly payment under IBR will never be higher than what it would have been under a standard 10-year repayment plan when you first entered IBR. Thus, for the life of the loan, the resident in the above example would never be required to pay more than \$1,784 per month.

### What about interest?

Under IBR, interest continues to accrue on both subsidized and unsubsidized loans. For many residents, the reduced monthly payment under IBR will not be sufficient to cover the interest that accrues each month. (Interest on \$155,000 @ 6.8% accrues at a rate of more than \$800 per month.) If your monthly payment is not sufficient to cover accrued interest, the federal government will pay any remaining accrued interest on subsidized loans for the first three years. Any unpaid interest on unsubsidized loans (as well as any unpaid interest on subsidized loans after the first three years) continues to accrue and is capitalized (added to the principal) when you leave IBR

1. Determine your monthly payment under a standard 10-year repayment plan using the loan payment calculator at [www.finaid.org/calculators/loanpayments.phtml](http://www.finaid.org/calculators/loanpayments.phtml).

2. Federal Poverty Level guidelines are available at <http://aspe.hhs.gov/poverty/09poverty.shtml>.

3. 2008 Association of American Medical Colleges (AAMC) Survey of Resident/Fellow Stipends and Benefits.

4. 2008 AAMC Graduation Questionnaire.

or no longer demonstrate a partial financial hardship. Consequently, it is possible that despite making payments throughout residency, your loan principal will be higher upon leaving IBR than it was when you entered the plan.

### *Loan forgiveness*

In addition to creating the new IBR plan, CCRAA provides borrowers with two opportunities for loan forgiveness:

If after 25 years of making reduced payments under IBR you still have not repaid your loan in full, any remaining balance on eligible loans will be forgiven.

Borrowers can also qualify for loan forgiveness through the new Public Service Loan Forgiveness program. After a borrower working full-time at a "public service organization" has made 120 reduced monthly payments under IBR, the balance of his or her eligible loans is forgiven. Public service organizations include federal, state, and local governmental entities as well as non-profit [501(c)(3)] organizations and private organizations that provide public health services. Check with your employer to ensure that your organization is considered a public service organization.

## **Other repayment options**

### *Standard 10-year repayment plan*

Repayment under a standard 10-year plan is always an available option. However, due to their low income relative to their high debt, standard repayment is not a realistic option for most residents. (The standard monthly loan payment for the average resident described in previous examples would consume well over half of his or her after-tax income.)

### *Forbearance*

If you can not or choose not to make the required minimum payment under IBR, you can request forbearance. You are not required to make monthly payments while your loans are in forbearance. However, interest continues to accrue on all loans (both subsidized and unsubsidized), and any unpaid interest is capitalized at the end of the forbearance period. As a result, forbearance can be an expensive option. (Three years of forbearance on \$155,000 @ 6.8% interest will ultimately cost nearly \$44,000 in additional interest.) Also, please note that forbearance is granted at the discretion of the lender and so is not guaranteed.

### *Comparing your repayment options*

As noted above, a standard 10-year repayment plan is not a realistic option for most residents, and most residents will therefore have to choose between IBR and forbearance. Unfortunately, because the circumstances relevant to a comparison of repayment options (current and anticipated

future income, loan balances, interest rates, length of residency, family size, etc.) vary widely from borrower to borrower, it is not possible to make an across-the-board comparison of the various repayment options. Instead, the advantages and disadvantages of each repayment option must be weighed with each borrower's unique situation in mind.

It is possible however to make one useful generalization: When choosing between IBR and forbearance, remember that lower payments today mean higher payments tomorrow and ultimately more interest paid over the life of the loan. You must decide for yourself whether the additional long-term cost of forbearance is a good trade-off for additional disposable income during residency.

### **Relative short- and long-term costs of repayment options<sup>5</sup>**

Repayment option during residency	Monthly payment		Total interest paid over life of loan
	During residency	After residency	
Standard (10-year)	\$\$	\$\$	\$
IBR	\$	\$\$\$	\$\$
Forbearance	—	\$\$\$\$	\$\$\$

## **What to do now**

### *Take advantage of 20/220 while you still can*

Economic hardship deferment under the 20/220 pathway is still available until July 1, 2009. If your loans are already in repayment, or will be as of June 30, you may be eligible for one more year of deferment.<sup>6</sup> However, you must contact your lender and be eligible for deferment **before July 1, 2009**.

### *Research IBR and other options*

More information about IBR, including calculators to help you weigh your options, is available at these Web sites:

- [www.finaid.org/loans/ibr.phtml](http://www.finaid.org/loans/ibr.phtml)
- <http://www.finaid.org/calculators/ibr.phtml>
- [www.aamc.org/programs/first/facts/incomebased.pdf](http://www.aamc.org/programs/first/facts/incomebased.pdf)
- [www.IBRinfo.org](http://www.IBRinfo.org)

Be sure to contact your lender and a financial planning expert before making any decisions about loan repayment.

### *Learn more about debt management*

For helpful information on debt management, please refer to the AMA's *Succeeding from Medical School to Practice* guide, an online resource available exclusively to AMA members:

- [www.ama-assn.org/go/succeeding](http://www.ama-assn.org/go/succeeding)

### *Contact us with any questions*

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- AMA Department of Medical Student Services: [mss@ama-assn.org](mailto:mss@ama-assn.org)

5. A tangible comparison of various repayment scenarios is available at [www.aamc.org/programs/first/students/assumptions.htm](http://www.aamc.org/programs/first/students/assumptions.htm).

6. An economic hardship deferment calculator is available at [www.aamc.org/programs/first/students/tools/ehdcalc/start.htm](http://www.aamc.org/programs/first/students/tools/ehdcalc/start.htm).