

WHAT MEDICAL SCHOOL GRADUATES SHOULD KNOW ABOUT INCOME-BASED REPAYMENT

Summary

Beginning July 1, 2009, Income-Based Repayment (IBR) offers a new way for medical school graduates to manage their monthly federal student loan payments, and may be especially helpful during their residency. IBR is designed to assist borrowers who need to adjust their federal student loan payments relative to their income. Monthly payments are adjusted annually to reflect changes in household income or size.

Also effective July 1, 2009, due to changes in Economic-Hardship Deferment (EHD) eligibility rules, most medical residents will no longer be able to qualify for hardship deferment. Therefore, medical school graduates may want to consider enrolling in the IBR plan as an alternative to EHD.

Under IBR, medical school graduates can take up to 25 years to repay their federal loans. IBR also offers a loan forgiveness program for economically challenged borrowers who are unable to repay their loans in full after making payments for 25 years. (A separate federal program provides loan forgiveness after just 10 years' worth of payments to borrowers who pursue public service careers. See Loan Forgiveness for Public Service information sheet from Sallie Mae[®].)


Eligibility and Qualifications

Before borrowers enroll in IBR, they need to understand how the plan works:

- IBR is available to borrowers who demonstrate Partial Financial Hardship, according to a formula established by federal statute.
- The IBR hardship eligibility formula takes into account the original standard monthly payment amount for each eligible IBR loan, even if there are loans from multiple lenders and/or loan servicers. Borrowers may include eligible loans issued under the Federal Family Education Loan Program—that is, by a private lender such as Sallie Mae—or under the U.S. Department of Education's Direct Loan Program.
- IBR-eligible loans include federal loans issued to students: Subsidized Stafford Loans, Unsubsidized Stafford Loans, Graduate PLUS Loans, and Federal Consolidation Loans that did not include any Parent PLUS Loans. If borrowers consolidated Federal Perkins or any federal health education loans, these consolidation loans are still IBR eligible. Unconsolidated Perkins and health-education loans are not eligible for IBR. Parent PLUS Loans are not eligible, nor are any defaulted student loans.
- If the borrower qualifies, the total student loan monthly payment for IBR-eligible loans cannot exceed 15% of the borrower's discretionary income, which is determined by subtracting 150% of the poverty level for the borrower's household size from his or her adjusted gross income (AGI).
- To enroll in IBR, borrowers must agree to allow their lender or loan servicer to access their federal tax records to confirm the AGI reported on their most recent return.

Key Features

Under the IBR plan, it is possible for the monthly IBR payment to be less than the accruing interest. For up to three consecutive years of repayment, the federal government will pay any accruing interest on the borrower's Subsidized Stafford Loans and the subsidized portion of the borrower's Federal Consolidation Loan that isn't covered by the borrower's IBR payments that are allocated to these loans. After the three-year subsidy period is exhausted, the borrower becomes responsible for all of the unpaid interest accruing to the subsidized portions of the loans being repaid under IBR. The borrower is always responsible for the unpaid interest that accrues on any unsubsidized loans.



A key feature of IBR is the payment cap: A borrower's maximum IBR payment cannot exceed the amount required initially to pay off the amount of loans placed under the IBR plan, in equal installments, over a 10-year term.

In general, a borrower's monthly IBR payments are likely to rise along with increases in the borrower's income. Payments may also be affected by marriage and/or the birth of a child. An increase in household size will lower the payment amount. Marriage will increase the payment amount if the spouse is employed and the couple files a joint tax return. According to federal rules, a spouse's income cannot be excluded from the IBR eligibility calculations unless the couple files separate tax returns.

Note: In May 2009, the U.S. Department of Education said it planned to make it easier for married borrowers who both have education loans to qualify for IBR. The change, which would pro-rate a couple's joint AGI based on each spouse's loan balance, is slated to take effect July 1, 2010.

The maximum repayment period under this plan may extend beyond 10 years. If borrowers meet certain requirements, any balance remaining after 25 years may be eligible for forgiveness. According to current federal law, the amount forgiven is considered taxable income. However, most medical school graduates can expect to pay their loans in full within the 25-year term.

If borrowers later decide that they no longer wish to remain in the IBR plan, federal rules require them to first move to a standard repayment plan that calls for equal installments over the remaining term, which is likely to be less than 10 years. Once enrolled in a standard repayment plan, borrowers can then switch to another plan, such as graduated repayment.

Partial Financial Hardship (PFH)

As long as the borrower continues to demonstrate PFH, unpaid interest will continue to accrue on a simple basis—that is, the unpaid interest will not be capitalized (added to the principal balance). Under the IBR plan, accrued, unpaid interest cannot be capitalized until the borrower no longer qualifies for PFH or leaves the IBR plan. Borrowers must re-establish eligibility for PFH status on a yearly basis by granting the lender access to the borrower's income tax information in order to get a lower monthly payment. If he or she experiences significant income growth, the borrower may no longer qualify for PFH. However, federal rules allow borrowers to remain in this plan even if they no longer experience PFH.

Public Service Loan Forgiveness

A small number of medical school graduates may be eligible for loan forgiveness after making payments for 10 years, if they are employed in qualified public service positions throughout those 10 years (amounts forgiven under the public service program will not be treated as taxable income.) Examples of public service positions include working as a pediatrician at a community health clinic or as a psychiatrist for a mental health program. Borrowers also must meet several other key rules, including a requirement that none of the 120 payments can be more than 15 days late. In addition, only loans issued by the U.S. Department of Education's Direct Loan Program are eligible for the public service forgiveness. Note: Loans issued by a private lender under the Federal Family Education Loan Program (FFELP) would have to be consolidated under a Direct Loan Consolidation Loan to be eligible. FFELP loan borrowers who consolidate may lose any unearned borrower benefits on their underlying loans. They should check with their lender or servicer for more details.

It's important to note that most medical doctors are likely to pay down a significant amount of their balance during the 10-year payment-qualification period. According to the U.S. Department of Education, "Only borrowers with a high debt-to-income ratio or consistently very low income will qualify for loan forgiveness under the Loan Forgiveness for Public Service Employees Program." For more information about this program, visit:

<http://studentaid.ed.gov/students/attachments/siteresources/LoanForgivenessv4.pdf>

Economic Hardship Deferment

Until now, the most popular method for minimizing student loan payments during residency has been Economic Hardship Deferment (EHD). Effective July 1, 2009, virtually all medical residents will no longer be able to qualify for EHD. Due to a scheduled change in federal rules, if a single borrower's gross income exceeds 150% of the poverty guideline for the borrower's household, economic hardship deferment isn't an option. For example, an annual medical residency salary of \$45,000 translates to \$3,750 per month. Under current poverty guidelines, a single borrower living in the continental U.S. would have to earn \$1,354 or less to qualify for EHD. Married residents and/or those with several children aren't likely to qualify either.



Medical Residency Forbearance

If a resident cannot afford to make the federal student loan payment required by IBR, he/she can explore medical residency forbearance. Under this option, borrowers can postpone payments of both principal and interest throughout residency. This type of forbearance is mandatory—that is, the lender must grant this forbearance if a borrower meets the eligibility rules and submits the necessary documentation.

A chief requirement is that the residency program has to be deemed necessary for the borrower to be certified to practice his/her medical discipline. There is no time limit for medical residency forbearance and most medical residents can expect to qualify. Borrowers can apply for this type of forbearance each year, and any unpaid interest could be capitalized as frequently as quarterly. Sallie Mae capitalizes at the end of forbearance. Unlike deferment, forbearance does not offer any interest subsidy; borrowers are responsible for paying the interest that accrues on subsidized as well as unsubsidized loans. Borrowers can elect to pay the interest as it accrues or have it be added to the principal balance.

Electing to use forbearance will not adversely affect a borrower's credit history. However, allowing interest to accrue during a lengthy forbearance will increase the total loan amount owed, which could eventually affect the borrower's credit score. To avoid this situation, the borrower can pay the interest as it accrues. What's more, many medical residents may be able to deduct the interest paid during residency forbearance on their federal tax return. To take this federal deduction, borrowers must meet a number of rules, including an income test. The federal interest deduction is also available to eligible borrowers who are in repayment. To find out more information about this deduction, visit the Internal Revenue Service web site at www.irs.gov and download Publication 970, *Tax Benefits for Education*.

Once out of medical residency forbearance, the borrower can choose to repay his or her federal loans under any of five available repayment plans: standard, graduated, extended, income-sensitive, or income-based repayment. The period spent in forbearance will not qualify toward the 120 months of payments required to qualify for the public service forgiveness program. In general, only payments made under the standard (10-year) repayment plan, IBR, or income-contingent repayment plan (available under the Direct Loan Program) can be counted toward the 120 monthly payments requirement.

Borrowers can use a worksheet at SallieMae.com to confirm their IBR eligibility and to estimate their initial IBR payment. Medical residents who have the ability to make some payment toward their student loans each month should contact their lenders or loan servicers for assistance in evaluating what their payments would be under IBR. Borrowers in repayment may enroll in the IBR plan on or after July 1, 2009.

Note: The information about the income-based repayment and public service loan forgiveness programs are based on information available in May 2009 and are subject to change. The calculations in the examples on the forthcoming pages are estimates only and are provided to help illustrate how IBR works and compares with other plans.

INCOME-BASED REPAYMENT SPRING 2009 MEDICAL SCHOOL GRADUATE EXAMPLE

TOTAL BALANCE - A TYPICAL LOAN PORTFOLIO FOR A MEDICAL SCHOOL GRADUATE						
Academic Year	Subsidized Stafford	Unsubsidized Stafford	Accrued Interest	at Start of Repayment	Interest Rate	Initial Monthly Payment
2005-06	\$8,500	\$30,000	\$5,961	\$44,461	4.75%*	\$466
2006-07	\$8,500	\$30,000	\$6,290	\$44,790	6.80%	\$515
2007-08	\$8,500	\$32,000	\$4,533	\$45,033	6.80%	\$518
2008-09	\$8,500	\$32,000	\$2,357	\$42,857	6.80%	\$493
Total Balance at Start of Repayment:			\$177,142			
Monthly Payment at Start of Repayment:			\$1,993			
* Borrower is assumed to have consolidated first-year Stafford Loans to lock in the variable rate in effect in June 2006. Consolidation Loan is assumed to be a Direct Loan Consolidation Loan, which at that time offered a six-month grace period.						
Assumptions: In this example, the borrower allows interest to accrue throughout medical school and the six-month grace period. The borrower's loans are first disbursed on August 1 of each academic year, and second disbursements are issued on January 1. The repayment period begins December 1, 2009, and the borrower elects to enter IBR at the start of the repayment period. The borrower's first-year Stafford Loans, which carried variable rates, were consolidated in June 2006, locking in a rate of 4.75%.						

Total Amount Borrowed

In the above chart, the borrower received \$158,000 in federal loans—\$34,000 in Subsidized Stafford Loans and \$124,000 in Unsubsidized Stafford Loans—to fund four years of medical school.

Total Amount (Including Interest) Owed

At the end of the six-month grace period on November 30, these loans (including accrued interest) are projected to total \$177,142 and the borrower's initial monthly payment amount, based on the Standard Repayment Plan is \$1,993.

Annual Student Loan Payments

The IBR eligibility formula measures annual income against the borrower's annual student loan payments, which, in this example, totals \$23,917 (\$1,993 X 12).

Sample Income Amount

In April 2009, the borrower filed a joint tax return for Federal Tax Year 2008, reporting the spouse's modest income as a substitute teacher. The couple's Adjusted Gross Income (AGI) is \$20,000. Medical school graduates who haven't filed a recent tax return can provide alternative documentation of their first-year resident's salary.

Sample Poverty Guideline Amount

In this example, the borrower has no other dependents and is starting a practice in the continental U.S. Thus, the annual Federal Poverty Income Guideline** for this household is \$14,570. Under the IBR eligibility formula, the borrower's poverty guideline is multiplied by 150%, equaling \$21,855.

Is The Borrower IBR Eligible?

The borrower easily meets the eligibility requirements for IBR. That's because the discretionary income is negative (\$20,000 minus the sample poverty amount of \$21,855 = -\$1,855).

Sample IBR Payment

Discretionary Income = \$0. Fifteen percent of Discretionary Income = \$0. Under IBR, the initial monthly payment would be set at \$0. IBR payment amounts are adjusted annually—up or down, depending on changes in the borrower's income and household. In this example, the borrower can expect a jump in his IBR payment in his second year of residency, reflecting the income reported on the 2009 tax return he files in April 2010. If his or her AGI rises to \$45,000, he can expect a monthly payment of approximately \$360, based on the current poverty income guidelines. What's more, new physicians can expect modest annual increases in their residency salaries and thus modest increases in their IBR payments. After residency, most doctors can expect to start earning six-figure incomes. But IBR imposes a maximum payment amount, which is based on the balances and interest rates in effect when the borrower enrolled in the plan. In this example, the monthly IBR payment can never exceed \$1,993—the amount required to repay the loans in full over a 10-year term.

**The Federal Poverty Income Guidelines are updated annually, by the U.S. Department of Health and Human Services.

More Medical School Graduate Examples

The big question for medical residents isn't whether they will qualify for IBR but whether they can afford to make any payment on their student loans—even the reduced payment required by IBR. Under IBR, most first-year residents can expect to make a payment of several hundred dollars. For example, a resident who owes \$160,000 in eligible federal loans and who is earning, say, \$45,000 a year can expect to qualify for IBR. For a single borrower living in the continental U.S., the initial IBR payment would be set at \$359 a month. As the borrower's residency salary increases, the borrower can expect the monthly IBR payment to rise modestly. Once the borrower is in private practice and earning six figures a year, the IBR payment will rise rapidly but is capped at the amount required to repay the \$160,000 over a 10-year term. Assuming an interest rate of 6.8%, the maximum monthly payment would be \$1,841 a month.

For residents living in high-cost areas and who can't afford any monthly student loan payment, forbearance remains an option. Medical school graduates should request residency forbearance, which allows them to postpone payments of principal and interest. There is no subsidy during forbearance, but residents can pay the interest as it accrues to avoid capitalization. There is no time limit for residency forbearance, which can be arranged in increments of up to 12 months.

Differences in a resident's family circumstances could boost or reduce the IBR payment. The IBR formula would establish a payment of \$219 for a married resident with a nonworking spouse and an infant child, assuming the same \$45,000 salary and six-figure debt. A married resident with no dependents reporting a joint income of \$75,000 would be asked to make a payment of \$664.



HELPFUL INFORMATION FOR COMPLETING THE IBR ELIGIBILITY WORKSHEET

(worksheet can be found on the next page)

Step 1: The Partial Financial Hardship test looks at the ability to repay federal loans. Under current federal rules, the test is based on the monthly payment amounts for all IBR-eligible loans at the time these loans entered repayment, based on a standard, 10-year repayment schedule.

- For Stafford Loans, repayment begins after the end of the six-month grace period.
- Graduate PLUS Loans enter repayment immediately upon full disbursement.
- Federal Consolidation Loans generally enter repayment at time of disbursement.

The formula requires the standard payment amount, which is the amount required to repay the initial repayment balance of a borrower's loan(s) in equal installments over a 10-year period. Borrowers must use the original standard payment amount even if they began repaying their loan(s) under a different repayment plan (such as a graduated or extended repayment plan) or their monthly payment amount has changed for any reason since their loans entered repayment. To make sure borrowers are using the correct payment information, they should check their loan documents (including their original repayment disclosure) or contact their lender or loan servicer.

Step 2: The formula is based on a measure of the borrower's annual income and 12 months' worth of standard monthly payments. Multiply the number entered in Box 1 by 12.

Step 3: In Box 3, borrowers enter the Adjusted Gross Income (AGI) listed on their most recent federal tax return.

Please note that the IBR application process requires borrowers to grant their lender or loan servicer the right to receive certain federal tax information from the IRS. Their lender or servicer will use this information to confirm the borrower's AGI.

If the borrower is married and filed a joint tax return, the IBR calculation must take into account any spousal income included in the AGI. If the borrower is married and the borrower and spouse filed separate returns, the IBR eligibility calculation will be based on the borrower's AGI.

If a borrower's income has changed significantly since the tax return was filed, or the borrower has not recently filed a federal tax return, he/she should enter an estimate of current annual income in Box 3. Although the lender must first check the federal tax database to confirm the borrower's most recent AGI, the lender can use alternative documentation to determine the borrower's income. Borrowers who need to use alternative income documentation should contact their lender or loan servicer for details.

Step 4: In Box 4, borrowers enter the number of individuals in their household. If they are single and have no dependents, they should enter 1. If a borrower or a member of the household is pregnant, the household size may include the unborn child if he/she is expected to arrive during the year for which the borrower is seeking IBR eligibility. Other dependents may qualify in certain circumstances.

Step 5: In Box 5, borrowers indicate whether they live in Alaska, Hawaii, or the continental United States. The poverty income guidelines used by the hardship eligibility formula take into account the higher cost of living in Alaska and Hawaii. However, for borrowers who live outside the United States, federal rules require the formula to use the poverty guidelines for the continental United States.

Step 6: Borrowers find the corresponding poverty-income guideline for their state of residency and household size in the table at the bottom of the worksheet page and enter this amount in Box 6.

Step 7: Borrowers multiply the amount in Box 6 by 1.5, then place this amount in Box 7. The federal hardship formula uses 150% of the poverty-level income that corresponds to a borrower's location and household size.

Step 8: Borrowers subtract the amount in Box 7 from the amount in Box 3, then place this amount in Box 8. The formula measures the income a borrower has in excess of the amount needed to cover his or her basic living expenses.

Step 9: Borrowers multiply the amount in Box 8 by 15% and then place the result in Box 9. Under the hardship formula, borrowers are eligible for IBR if their eligible federal student loan payments exceed 15% of their discretionary income.

Steps 10 & 11: Borrowers determine if the amount in Box 2 exceeds the amount in Box 9. If it does, borrowers may be eligible for IBR.

Step 12: If borrowers are eligible for IBR, they can estimate their initial monthly payment under this plan by dividing the amount in Box 9 by 12. If the amount is less than \$5, the payment is \$0. If the payment is between \$5 and \$10, the payment will be \$10. The amount in Box 12 is the maximum monthly payment a borrower would make each month for all of the loans placed in IBR. If borrowers have IBR-eligible loans with more than one lender or loan servicer, their monthly payment will be allocated among their lenders, on a pro rata basis. Borrowers should inform each servicer about any loans they have with other lenders.

IBR eligibility and monthly payment worksheet

IBR is available to those experiencing Partial Financial Hardship. Borrowers can estimate their IBR eligibility by completing this worksheet. Borrowers should contact their lenders or loan servicers to confirm their eligibility and IBR monthly payment amount.*

		Example	Your IBR Eligibility Calculations
1	Total of the initial monthly payments for all your eligible federal loans—under the standard 10-year level repayment plan at the start of repayment for each loan—for example, at the end of your grace period for your Stafford loans. Includes Subsidized and Unsubsidized Stafford Loans, Graduate PLUS Loans, and Federal Consolidation Loans that did not include a Parent PLUS Loan. Do not include any defaulted loans. Check your loan documents or contact your loan servicer for assistance.	\$197	\$ _____
2	12 months worth of your initial standard monthly payments: 12 X the amount in Box 1.	\$2,364	\$ _____
3	The AGI reported on your most recent federal tax return. If you are married and filed a joint return, federal rules require you to include your spouse's income as well as yours. You can use alternative income documentation if you do not have a recent federal tax return or your current income is significantly different from your most recent AGI. Contact your lender or loan servicer for details.	\$20,000	\$ _____
4	Number of individuals in your household.	1	
5	Where do you live: Alaska, Hawaii or continental United States?	Continental U.S.	
6	HHS poverty guideline for your household —Select appropriate poverty guideline from table below.	\$10,830	\$ _____
7	150% of your poverty guideline —Multiply the amount in Box 6 by 1.5.	\$16,245	\$ _____
8	AGI Above 150% of your poverty guideline —Amount in Box 3 minus amount in Box 7.	\$3,755	\$ _____
9	15% of AGI above 150% of your poverty guideline —Multiply the amount in Box 8 by 15%.	\$563	\$ _____
10	Do your annual loan payments exceed 15% of your AGI after subtracting 150% of your poverty guideline? That is, does the amount in Box 2 exceed the amount in Box 9?	Yes	
11	If the answer in Box 10 is "Yes", you appear to be eligible for the IBR. Eligible borrowers may enroll in the IBR on or after July 1, 2009. Please contact your loan servicer to confirm eligibility and for details on how to enroll.	IBR Eligible*	
12	Your IBR payment = 1/12th of your available income —that is, 15% of the amount of AGI remaining after subtracting 150% of your poverty guideline. Divide the amount in Box 9 by 12.	\$47	\$ _____

HHS Poverty Guidelines for 2009

Household Size	Contiguous 48 States**	Alaska	Hawaii	
1	\$10,830	\$13,530	\$12,460	Tip: Your household size includes yourself, a spouse, and any dependent children, including a child who is expected to be born during the year you are seeking to enroll under the IBR.
2	\$14,570	\$18,210	\$16,760	
3	\$18,310	\$22,890	\$21,060	
4	\$22,050	\$27,570	\$25,360	
5	\$25,790	\$32,250	\$29,660	
6	\$29,530	\$36,930	\$33,960	
7	\$33,270	\$41,610	\$38,260	
8	\$37,010	\$46,290	\$42,560	
For each extra person in household, add:				
	\$3,740	\$4,680	\$4,300	

*This worksheet provides only an estimate of whether a borrower will be eligible to use the IBR. Eligibility for the IBR can only be confirmed by the borrower's lender or loan servicer after the borrower submits the necessary information and the borrower's income has been confirmed.

**Borrowers who live outside the United States should use the poverty guidelines for the contiguous 48 states.