GREATER ALBUQUERQUE MEDICAL ASSOCIATION

Clarissa Krinsky MD, CFP®
ClariFinancial, LLC

THE DOCTOR'S LOAN

Much of the first year after I left my practice in Forensic Pathology to pursue a career in financial planning was spent thinking, "Wow! I wish I had known that…." It has been apparent to me in my life, and as I guide my physician clients through financial decisions, that we are not always well-prepared for the labyrinth of the world of money. Hopefully, I will be able to share a little bit of the wisdom I have gained over the past few years as a physician and financial planner. Feel free to reach out anytime with questions!

Last week, I met with a client who is just about to complete a three-year fellowship in a peds subspecialty. He and his wife have two small kids and have lived wisely and within their means with no debt outside of average student loans. I could see the wistful sparkle in their eyes as they talked about what size home they could afford to buy as he begins his first job in a new town this summer.

"Luckily, we qualify for a doctor's loan!" he exclaimed. I knew that they were not going to like the advice I so often dish out to those just finishing their training. This is a treacherous time as you set a course on the path of your new life beyond residency and fellowship. It is a tempting time to buy the car, the house, and the vacation you have longed for. But, that can create some serious issues.

First, many physicians find themselves changing jobs or moving around in those first few years of practice. Those first years out are challenging! Being stuck in a large mortgage or, as we learned in 2008, quickly getting under water on a home can be an obstacle to making a smart career move. In addition, many folks overestimate what their take-home pay will be based upon a job offer. That first six figure offer sounds amazing, but it is quickly diminished by retirement savings, healthcare costs, insurance premiums, parking, fees, and other expenses incurred in practice. So, we can quickly find ourselves overcommitted to a mortgage.

It is also important to really consider the pros and cons of the “doctor loan” offered by mortgage lenders. These loans are designed to work around the usual down payments required to avoid the private mortgage insurance (PMI) that is added when you make a down payment of less than 20%. PMI is essentially a price you pay the lender to reward them for taking the risk of a loan without a down payment. It can range from 0.3% - 1.5% of the original loan amount a year and depends on your down payment and credit score. For a $500,000 loan, that could be up to $7500.00 a year. Lastly, the lenders also usually waive rate increases on jumbo loans.

The lenders are willing to do this because they know physicians are likely to have a steady, high income but often emerge from training with little to no cash on reserve and may have a credit score bruised by student loan debt. Thus, they offer these riskier loans betting on your future earnings potential. The trade-off for the bank taking a greater risk on the loan is usually a slightly higher interest rate, sometimes as high as a full percent. Over the lifetime of a large home loan, this difference can have a profound impact on the time it takes to pay off a mortgage and the total amount of interest paid over that time.   The other risk is that with no money down you can very quickly get in trouble if home prices drop and you have little to no equity in the home.

So what’s a poor fellow to do? I usually recommend that folks fresh out of training, or physicians who are relocating, rent for a year or two and try to accumulate enough money to put 20% down and get a conventional loan. Not only will you still avoid PMI by putting 20% down, you’ll also get the lower rate of a conventional loan. More importantly, rather than dash on the financial cliff of a higher paycheck, you’ll figure out how your new paycheck fits into your life. You may find that the take-home pay is more or less than you expected or that you have other expenses, such as daycare, private school, new cars, travel, etc. that are more important than a large home. And, you can determine that the job, the city, and the neighborhood will all be a good fit.