Financial Planning

High Income, Jumbo School Debt: Smart Options for Clients

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Many people graduate from college with student debt, but doctors, dentists, scientists, lawyers and MBAs tend to run up particularly large totals — and they may struggle with repayments, even if their incomes are relatively high.

“Most of my clients in these professions have six-figure incomes, but they also have six-figure student loan debt, which they got while pursuing graduate degrees,” says Stacy Gallagher Ployhar, a planner at 2020 Financial Planning in Seattle.

These clients need to pay off their student loans in an optimal way. They also have other financial goals that are difficult to put off. “A common theme is that they are graduating, then getting married, then want to buy a home six months later and start a family within the year,” Ployhar says. “They also need to start saving for retirement, and they are at an age where they can’t do these things sequentially.”

A.J. Sohn, managing partner at Antaeus Wealth Advisors in Boxborough, Mass., often sees these professionals when they are in their late 30s — and still have educational debt. “They would love to be able to max out their 401(k)s, save more money for their kids’ college, pay their mortgages off faster,” Sohn says. “It’s not stopping them from doing what they want to do — it’s just keeping them from making faster progress toward their goals.”

‘COMPLICATED DECISIONS’

All student loan borrowers have options when it comes to their repayment plans. But high-earning professionals tend to be a special case, with specific needs and extra high balances to contend with. “People with high balances have complicated decisions to make,” says Heather Jarvis, an attorney in Wilmington, N.C., who specializes in student loan education.

To begin making those decisions, the first step is to get a clear loan inventory. “People often don’t know exactly what they have,” Sohn says, “and sometimes they don’t want to know, either. They know the approximations, but not the details of each underlying loan’s amount, rate and whether it’s subsidized or not.

My first advice for them is to really get the details, understand the facts and create a treatment plan.”

A typical six-figure student loan portfolio probably contains several different kinds of federal loans, as well as some private loans, at interest rates that may vary significantly. Unless the private loans are at very low rates, urge clients to pay them off first. “You have less future flexibility with those,” says Jorge Padilla, an advisor at the Lubitz Financial Group in Miami. For instance, borrowers who become unemployed can defer payments on government-backed student loans; there is no such option with most private loans.

REPAYMENT OPTIONS

Next, clients should consider their repayment plan options. Choices include the standard repayment plan, which involves 10 years of fixed monthly payments, and variations on the standard plan that allow for graduated or extended repayment.

Advisors say it’s relatively simple to discern whether a client would benefit from these latter plans, considering both current cash flow and the amount of interest the client would pay.

But income-based repayment options are trickier. Income-based, pay as you earn (PAYE), income-contingent and income-sensitive repayment plans let borrowers make 10 years or more of payments determined by their income and other expenses. At the end of the repayment term, the remaining balance is forgiven and taxed as regular income.

“For most medical and dental school graduates, probably nine times out of 10 we recommend PAYE or the income-based repayment plan,” says Adam Glassberg, a senior financial planner at D3 Financial Counselors in Downers Grove, Ill. “A lot of people with high debt loads don’t start off making a lot of money, and they can’t manage a 10-year repayment plan because the monthly payment is too high,” he adds. “$150,000 in debt at 6.8% for a government loan means a monthly payment of $1,726, or $20,700 a year. For a resident who is making $40,000 to $60,000 a year, that’s too much.”

Yet these plans don’t make as much sense for higher earners. “If you earn as much as you owe, or earn less than you owe, you’re probably a good candidate for these plans,” says Ajay Kaisth, an advisor at Kai Advisors in Princeton Junction, N.J., who sees many physicians saddled with serious debt. “But if you earn much more than you owe, you’re probably not a good candidate. ... You could reach the end of your payments and have nothing left to forgive. Or you could pay off your debt too slowly and end up paying more interest than you need to pay.”

LOAN FORGIVENESS

Clients who work for the government or a qualifying nonprofit — say, doctors who work at public or nonprofit hospitals — may also meet the requirements for public-service loan repayment. In these, debtors make payments and receive debt forgiveness, but with one big bonus: The forgiven amount is tax-free.

But such plans aren't always a great fit. Grant Meyer, a financial consultant at Fure Financial in Bloomington, Minn., has a client who is making between $250,000 and $300,000 as a hospital neurological radiologist. She owes nearly $250,000, almost entirely in medical school loans. And because her employer is a nonprofit, she qualifies for tax-free debt forgiveness.

Yet the income-based plans that go along with tax-free debt forgiveness wouldn't leave anything to forgive. A 20-year standard repayment plan is a better fit, Meyer says, allowing the client to save toward other goals.

Another option is refinancing graduate school loans through such organizations as SoFi and CommonBond. "I have a client who is a Michigan law school grad and had $150,000 in debt at 7%," says Trent Porter, the founder of Priority Financial Planning in Denver. "It's refinanced through SoFi at 2.6%."

There's a downside, however, Porter notes. "He's giving up the ability to have income-based repayment. He can't become a public defender and have the payments go down, and he can't take a break from payments."

That's precisely the trouble with refinancing student loans, Jarvis says. "Refinancing ideas are fine as long as nothing goes wrong. ... If the trade-off works, lovely — but it doesn't always work."

And remember to discuss other debt with clients as well — because that may change the client's approach. "Sometimes I get into the student loan repayment discussion, and it comes up that the person also has $30,000 in credit card debt," Glassberg says. "You have to construct a loan repayment plan that works in the context of total debt. You want to pay down the higher-rate debt — consumer debt, private educational loans — before you pay back government-backed student loans."

At a certain point, clients must make hard choices between financial goals. If clients have money in a savings account making 1%, for instance, they would do better to retire their student loans.

"That seriously doesn't occur to people," Sohn says. "The money in the bank seems real to them, but the loan doesn't. ... You don't want to deplete their emergency funds, but if there's excess money, why not use it to eliminate the debt?"

They should probably put off other investing, however, depending on their loan rate. "There's usually a trade-off between investing and paying off the loans," Porter says. "If you've got loans at 7%, that's a guaranteed return."

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