

WHAT DENTAL SCHOOL GRADUATES SHOULD KNOW ABOUT INCOME-BASED REPAYMENT



Summary

Beginning July 1, 2009, Income-Based Repayment (IBR) offers a new way for dental school graduates to manage their monthly federal student loan payments, and may be especially helpful during the early years of their dental practice. 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 dental school graduates who are entering practice will no longer be able to qualify for hardship deferment. Therefore, dental school graduates may want to consider enrolling in the IBR plan as an alternative to EHD.

Under IBR, dental 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 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 (PFH), 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 the borrower's 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 initially required to pay off the amount of loans initially placed under the IBR plan, in equal installments, over a 10-year term.

The 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 dental 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 partial financial hardship 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 the borrower experiences significant income growth, the borrower may no longer qualify for PFH. However, federal rules allow borrowers to remain in the IBR plan even if they no longer experience PFH.

In-School Deferment

IBR may not be the best option for dental school graduates who are continuing their studies to pursue a dental specialty such as oral surgery. In this scenario, a borrower is likely to qualify for an in-school deferment, which allows the student to postpone payments of both principal and interest, and the federal government will subsidize—that is, pay—all of the interest that accrues on subsidized federal loans. Borrowers who are enrolling in a post-graduate program should check with the financial aid officer at their school to find out if deferment is possible.

During the deferment, borrowers can elect to pay the interest that accrues on unsubsidized loans or allow it to be added to the principal balance at the end of the deferment. Electing to use a deferment will not adversely affect a borrower's credit history. However, allowing interest to accrue during a lengthy deferment will increase the total loan amount owed, which could eventually affect a credit score.

To avoid this situation, borrowers can pay the interest as it accrues. What's more, they may be able to deduct the interest paid during a deferment, if they have any taxable income to report. 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. Borrowers can find out more information about this deduction by visiting the Internal Revenue Service web site at www.irs.gov and downloading Publication 970, *Tax Benefits for Education*.

Public Service Loan Forgiveness

A small number of dental school graduates may be eligible for loan forgiveness after making payments for 10 years, if they are employed in a qualified public service position throughout those 10 years (amounts forgiven under the public service program will not be treated as taxable income.) An example of a public service position would be working as a dentist at a community health clinic. 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 dentists 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>

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 are estimates only and are provided to help illustrate how IBR works and compares with other plans.

INCOME-BASED REPAYMENT SPRING 2009 DENTAL SCHOOL GRADUATE EXAMPLE

A TYPICAL LOAN PORTFOLIO FOR A DENTAL 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		
<small>* 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 dental 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%.</small>						

Total Amount Borrowed

On 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 dental 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. Dental school graduates who haven't filed a recent tax return can provide alternative documentation of their first-year dental practice income.

Sample Poverty Guideline Amount

In this example, the borrower has no other dependents and is starting a practice in 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. Annual Student Loan Payments = \$23,917 (\$1,993 X 12). 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 general, dental school graduates can expect significant increases in their monthly payments during the first few years of repayment under IBR.

Soon after entering practice, most dentists can expect to earn six-figure incomes. But IBR imposes a maximum payment amount, which is based on the balances and interest rates in effect when the borrower enrolls 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 Dental School Graduate Examples

Eligibility for IBR depends on each borrower's individual circumstances, and some spring 2009 dental school graduates could qualify for a very low initial payment under the IBR plan.

Consider a married student who, in April 2009, files a joint tax return for Tax Year 2008, reporting an AGI of \$25,000—money the spouse earned as a substitute teacher. The borrower owes \$160,000 in IBR-eligible loans, but the spouse has no education loans. The couple has no dependents and lives in the continental U.S. Under IBR, the borrower can expect a monthly payment of just \$39 during the first 12 months of repayment. If the couple reported a lower AGI—say, \$20,000—the initial payment would be set at \$0, because, under the IBR payment formula, \$20,000 isn't quite enough to cover necessities, which means the couple didn't have any discretionary income in 2008.

However, given typical income growth patterns for dentists, this borrower should expect a rapid increase in his or her monthly payments, subject to a cap of \$1,841, assuming an initial repayment balance of \$160,000 and a fixed interest rate of 6.8%. What about a newly-minted dentist, who is single, has no dependents, lives in the Midwest, and is earning \$85,000 a year? This borrower would qualify for IBR and can expect to make an initial monthly payment of \$859. Depending on changes in the borrower's income and household size, this payment could rise to as high as \$1,841. If financially successful, this dentist can expect to repay the \$160,000 within 15 to 20 years.

Before signing up for IBR, borrowers should explore other options for managing their student loans after dental school. Federal Stafford, Graduate PLUS, and Consolidation Loans offer several repayment options. In addition to the Standard Repayment plan that calls for equal installments paid over a 10-year term, lenders must offer Graduated Repayment plans that typically offer interest-only payments in the first few years and an Extended Repayment plan that allows borrowers to stretch their payments over a 25-year term. The accompanying table shows how payments would vary for a borrower with \$160,000 in Stafford Loans carrying a rate of 6.8% under three commonly used payment plans.

Comparing Traditional Repayment Options		
Initial Repayment Balance		\$160,000
Interest Rate		6.8%
Payment Plan	Monthly Payment/Term	Total Payments
Standard	\$1,841 for 120 months	\$220,954
Graduated	\$907 for 24 months	\$229,648
	\$2,166 for 96 months	
Extended	\$1,111 for 300 months	\$333,155