What To Do If You Have Monster Debt

[Editor's Note 1/15/2018: The long-awaited White Coat Investor Online Course is live and is available for purchase here. The course is entitled: Fire Your Financial Advisor. No more wading through dozens of books at the library, scrolling through hundreds of blog posts on dozens of blogs, *or checking in daily with online forums trying to gain a financial education the way the hobbyists do. This course will take you from feeling anxious and having no plan to having a written financial plan you can follow the rest of your investing career as a professional and a retiree. This course is the material that should have been taught to you in college, medical school, or residency, but never was.]*

Q.

I know you hear lots of people's financial woes. I almost never read articles that include situations similar to ours, and am beginning to feel that we are way out of the norm.

My partner and I both went to one of the most expensive medical schools in California. With tuition and living expenses, our combined debts currently stand at 840K (about

420K each), with interest accruing at about 6.5% for half the amount, and 7.6% for the other half. We are both in residency, Psych and IM.

We’ve been trying to live as frugally as possible in California and our families are both here. We’ve started saving for retirement in Roth IRAs and have a $10K emergency fund and are also starting to save for a house. We are about to apply for disability insurance which looks like it will cost us about $500/month for both of us. I am worried about refinancing our loans into private loans because of the loss of the ability to
defer/forbearance in case of hardship and the damage it might have to our credit. At this point, our plan is to aggressively pay our loans after graduation. If I pay 5K/month on my loan, then it should be paid off in 10 years.

Right now, I want to make sure that we put the best plan into place for both saving and paying down the loans simultaneously. Now the cherry on top, is that my widowed mother is likely to need financial help from us pretty soon (1 year), thinking we may need to purchase a large enough house for her to live with us, and take care of her regular expenses.

What is your general advice for those of us who have exorbitant sums of loans? I doubt PSLF will help us if it is even still there 7 years from now, so ignoring the PSLF possibility, what is the least worst way to go about this?

A.

Unfortunately, this situation is not only not rare, but it is becoming increasingly common, particularly among dentists as you can hear in this call to the Dave Ramsey show I shared a while back.

$840K is a lot of student loan debt, but it still isn't my record ($950K for two docs, $635K for one, send me an email if you can beat it.)

[Update 4/17: Record has continually increased since writing this- $800K, $940K, and now $1.2M for one doc. OMFS and orthodontists seem to lead the pack.]

But there's no doubt these two docs are in some serious financial hot water. Consider these four factors:

1) Huge debt
2) Relatively high interest rate debt
3) Low paying specialties
4) Living in a very high cost of living area

Why is this so bad? Well, the interest alone on that debt is about $60K a year. So it will cost them $5K in after-tax dollars a month just to stand still. That may be half of one of their after-tax monthly incomes!

The good news is that they realize that this is a problem. They realize they need to save and have already begun to do so. They're developing a financial plan. They're having a little trouble prioritizing their savings, but that's a relatively minor issue. The major issue is the $840K elephant in the room. I'm not quite convinced they understood just how bad that was. Dealing with that mess requires a radical solution, and I didn't hear a radical solution in the email. But they're probably only at a peak income to student loan debt ratio of 2X. As I wrote about recently, that's at least still doable. 3X, or even 4X (like the dentist in the Dave Ramsey call with a $480K debt and a $120K income) probably isn't.

Here’s what this couple (and all of you out there like them) need to consider.

1 Mindset Change

It’s time to change your mindset. You’re not only broke, you’re far worse than broke. You’re over $800K away from broke. You’re in a worse financial position than 99.99% of other Americans. The dude living under the bridge is in better financial shape than you are. You’re in no position to buy a house. You’re in no position to help anyone else financially. You’re in no position to live in a high cost of living area, no matter how many family members you have there. You’re in some deep crap. Your debt to income ratio is radical, and a radical solution is required.

2 Public Service Loan Forgiveness

This type of situation is ideal for a method of paying for school that doesn’t involve paying the loans back yourself. If you saw this coming before med school (expensive school and a low paying specialty) the military HPSP scholarship is a great option for someone with a desire to serve. That’s obviously not an option now. But Public Service Loan Forgiveness (PSLF) is. PSLF, assuming they are grandfathered in, eliminates this problem in just a few more years. The internist will already have 3 years of payments by residency graduation, and might even consider a fellowship. The psychiatrist has 4 years of payments already. 4-7 more years and they both could qualify for tax-free forgiveness, probably of an amount approaching a million dollars (after-tax mind you), but certainly at least half a million. That's like an extra 3-5 years of gross income! It's a huge benefit. What do they have to do to get it? Not much. Stick around as faculty at their programs. Go over to the VA and work (easy to get a job there as an internist and a psychiatrist I would think.) Maybe they can even find a non-profit, non-academic employer in California. But to just write this option off when you owe upwards of $800K seems foolish to me.

The kids wondered why we didn't get a llama to carry their stuff

3 California Is Part of the Problem

Here's another consideration- living in California is probably a significant part of the problem. A doctor leaving California for a less balmy climate typically gets heavily rewarded for suffering through it. Lower state taxes, a lower cost of living, and probably even higher salaries. After-tax, it wouldn't be unusual to make 50% more and spend half as much. That 2X ratio could easily be knocked down to 1.5X.

4 Boosting Income

Too many financial blogs focus on reusing paper towels to save money. That isn't going to go very far against a debt that accumulates $5K in interest a month. Physicians have a high ability to earn, and when you get out of residency it's time to take advantage of that fact to improve your financial fortune. Extra shifts, a better paying job, a side gig, you name it. Plus, when you're working you're not spending. "Live like a resident" can refer not only to your spending habits, but also your working habits.

5 Don't Fear Refinancing

Refinancing your student loans with a private lender does come at a price, but this couple seem to be afraid of the wrong price. They're worried about not being able to make the payments. They should be worried about not being able to go for PSLF. At any rate, cutting that interest rate in half if possible would go a long way to paying these loans off quickly. Upon residency graduation if they're sure they're going to pay them off and not try to get them forgiven, it's time to refinance. What are they really worried about? If something terrible happens to their income and they can't make their payments SoFi or CommonBond isn't going to come over and repossess their brains. Remember what a student loan is- an unsecured debt. If you stop paying, all they can do is report you to a credit bureau and call you every now and then. All the Credit Bureau folks do is lower your credit score. Well, if your income has dropped so much you can't make your student loan payments, you don't need credit anyway. It doesn't take that long to repair credit. By the time you're in a position to buy a house (hopefully the only thing you need credit for in the future), your credit will be ready too. Paying an extra

$25K a year in interest so you can go back to IBR payments "just in case" seems pretty foolish to me. IBR/PAYE/REPAYE forgiveness, which is taxable, isn't an attractive option either for this couple. That means they'll be dragging their debt out for 20-25 years. No, thank you.

6 Get Intense!

Even dragging loans out for 10 years would be depressing to me. I'm about ten years out of residency as I write this. Not only have my "student loans" been gone for years, I'm basically done saving for college, done saving for retirement, have the mortgage paid off, and am "living the good life." Correct me if I'm wrong, but isn't THIS what you want a decade out of residency? Or would you prefer to still be screwing around with student loan payments? Do yourself a favor and get rid of those loans in 5 years or less. Will it mean hard work? Absolutely. Will it require serious lifestyle sacrifice compared to your income and peers? For sure. Will it be worth it? I think so. Here's what it looks like:

Income: $400K
Taxes: $100K
Debt repayment: $200K
Living expenses: $100K

$100K goes pretty far in California, and it goes a long way outside of California. You can probably even save a little for retirement out of that. But the key is figuring out a way to be throwing $200K a year at the loans. That means that you're not making $5K a month payments. It means you're making $15-20K a month payments. You can do it! Think of how nice it will be to have an extra $200K in income! It's like marrying a doctor! That can be yours in less than 5 years, but you've got to choose now.

What do you think? What advice do you have for a doctor with “extreme debt?” What is the best choice now for their limited disposable dollars? Comment below!