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ABSTRACT

A study was done to evaluate the ability of medical residents to repay their Stafford loan educational debt with a repayment deferment limit of 2 years. Using data on 1990 medical school graduates, the study compared medical residents' educational debt burdens to a financial hardship indicator keyed to loan default prevention. Results indicated that requiring medical residents to begin repaying their Stafford loans could cause them financial hardship. Third- and fifth-year residents would use about 17 and 18 percent of their gross income to meet student loans obligations, exceeding the 10 percent considered to be unmanageable. In addition, the study found that residents could make their loan debt more manageable by exercising debt relief options such as obtaining forbearance of principal and interest for Stafford loans. Complete forbearance on Stafford loans would reduce debt burdens to 4 and 7 percent, reflecting student loan payments other than Stafford and comparable with those incurred by nonmedical borrowers. As lenders are currently not required to provide residents complete forbearance, the U.S. Department of Education plans to revise regulations to require lenders to honor such requests for complete forbearance. Appendixes contain the bulk of the report, with sections on methodology, three tables displaying the results, and a list of contributors to the report. (JB)

GAO

United States General Accounting Office

Report to Congressional Requesters

November 1991

MEDICAL RESIDENTS

Options Exist to Make Student Loan Payments Manageable

HE 025 162

GAO/HRD-92-21

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-244397

November 26, 1991

The Honorable Edward M. Kennedy
Chairman, Committee on Labor
and Human Resources
United States Senate

The Honorable Claiborne Pell
Chairman, Subcommittee on Education,
Arts and the Humanities
Committee on Labor and Human Resources
United States Senate

Beginning in January 1990, the Congress limited medical residency deferments for repayment of Stafford loans to 2 years. Subsequently, some medical residents complained about incurring financial hardship to meet their student loan repayment requirements. Over 180 Members of Congress, concerned about this potential hardship, have cosponsored legislation that would extend the residency deferment for the duration of residency training. To help you assess the need to extend the deferment, we evaluated the ability of medical residents to repay their educational debt.

Background

Residents typically have higher educational debt than other student borrowers, and about half of the debt of 1990 medical school graduates responding to a survey is from Stafford loans. Repayment for Stafford loans normally begins during the third year of residency, following a 6-month grace period and a 2-year residency deferment. The federal government pays the interest during this time. However, residency training programs typically range from 3 to 7 years, depending on the specialty.

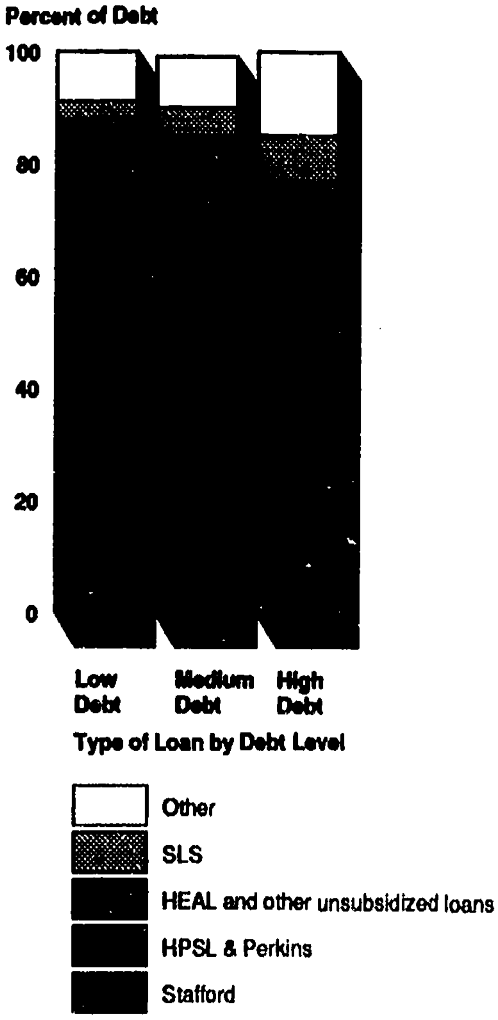
Residency training provides medical school graduates with supervised training in medical facilities, such as hospitals. Such specialties as family medicine, internal medicine, and pediatrics require a 3-year residency for board certification. In contrast, specialties like general and plastic surgery require 5 and 7 years, respectively.

Residents receive stipends, which increase as they advance in their training. According to the Association of American Medical Colleges, first-year residents received a median stipend of about $25,300 for the July 1990 to June 1991 year. The median stipend for third-year residents—the point when Stafford loans enter repayment—was about $28,100.

Medical Residents Use a Mixture of Loans

Medical students incur substantial educational debt from a variety of sources. Generally, medical students first exhaust opportunities to borrow below-market interest rate loans, such as Perkins loans and Health Professions Student Loans (HPSL). When additional financial resources are needed, these students then borrow from unsubsidized loan programs that typically charge variable-market interest rates, such as Supplemental Loans for Students (SLS) and Health Education Assistance Loans (HEAL). About 80 percent of the graduates responding to a 1990 medical association survey borrowed to finance their education, and their median debt was $40,000. Most of these graduates borrowed from at least three different loan sources. Figure 1 shows the distribution of their educational debt at the three levels of debt we analyzed. See appendix I for a detailed description of these debt levels.

Figure 1: Percent of Money Borrowed Under Various Loans by Debt Level



Postponing and Reducing Stafford Loan Payments

Effective January 1990, Public Law 101-239 restricted the medical residency deferment to 2 years. Before this change, officials at some medical facilities certified medical residents as students, qualifying them for in-school deferments. These residents could receive Stafford loan deferments for the duration of their residency training. During the deferment period, individuals who qualify for deferments make no loan payments and the federal government pays the interest.

Public Law 101-239 also requires lenders to grant forbearance of Stafford loans to medical residents upon request. Lenders may give forbearance by permitting payments to cease temporarily, allowing an extension of time for making payments, or accepting smaller payments. Unlike the case with deferments, interest that accumulates during forbearance is the resident's responsibility.

When forbearance is granted, residents can reduce or postpone Stafford loan payments until they leave the residency. In the Department of Education regulations, forbearance includes permitting no payments or accepting smaller payments, such as interest-only payments. The law does not specify which form of forbearance lenders are required to grant. We use the term "complete forbearance" to mean no payments, and the term "partial forbearance" to mean interest-only payments.

Medical residents can also use the loan consolidation program established by the Higher Education Act, as amended, to reduce their student loan payments. Consolidation allows borrowers—depending on their indebtedness—to extend loan repayment up to a maximum of 25 years, thereby lowering loan payments.[1] Graduated payment plans are also available to residents through the consolidation program. Borrowers who use graduated payments pay only the interest portion of their debt during the early years of repayment.

Objective, Scope, and Methodology

Our objective was to evaluate the ability of medical residents to repay their educational debt. We developed debt scenarios based on data that 1990 medical school graduates reported to the Association of American Medical Colleges. Using these data, we

[1] All student borrowers who have Stafford, SLS, Perkins, and HPSL debt may be able to consolidate their loans. To be eligible, a borrower must owe at least $5,000 from these sources. Maximum repayment terms range from 10 years for $5,000 to 25 years for $45,000 or more in loans.

- calculated anticipated student loan payments and debt burdens for residents in their third year—the point when Stafford loans enter repayment—and fifth year--the point when all federal loans have entered repayment;[2]
- compared the repayment ability of medical residents to certain non-medical borrowers; and
- assessed the impact that Stafford loan forbearance options have on student loan payments and debt burdens for third- and fifth-year medical residents.

We compared medical residents' educational debt burdens to a financial hardship indicator. Lenders usually limit credit to individuals, anticipating that debt beyond a certain level causes financial hardship, which in turn, leads to defaults. Industry sources indicate that commercial lenders typically allow nonhousing debt to range from 8 to 12 percent of gross income. Since loan default prevention is one of the Department's central responsibilities under the Stafford program, we used Department criteria to distinguish between manageable debt and financial hardship—10 percent of gross income.[3]

More details on our scope and methodology are contained in appendix I.

Results in Brief

Requiring medical residents to begin repaying their Stafford loans could cause them financial hardship, based on our analysis of medical residents' debt scenarios. Third- and fifth-year residents would use about 17 and 18 percent, respectively, of their gross income to meet student loan obligations.[4] This would exceed 10 percent of gross income, a point at which the Department considers educational debt to be unmanageable.

Medical residents can, however, make their student loan debt more manageable by exercising debt relief options. One such option is to obtain forbearance of principal and interest for Stafford loan payments. When lenders give residents complete forbearance, their debt burden, the ratio of student loan payment to gross income, falls below 10 percent of gross

[2]We define debt burden as the ratio of student loan payments to income.

[3]We have no basis to agree that nonhousing debt exceeding 10 percent of gross income constitutes a financial hardship. We do believe, however, that the 10-percent standard, which represents the mid-range of criteria used by commercial lenders, is suitable for comparative purposes.

[4]Unless otherwise noted, our results pertain to the graduates at the medium debt level. Results of analyses of the low and high levels are shown in appendixes II, III, and IV.

income. Third- and fifth-year residents who obtain complete forbearance would incur debt burdens of 4 and 7 percent of gross income, respectively. These debt burdens, which reflect student loan payments other than Stafford, are comparable with those incurred by nonmedical borrowers.

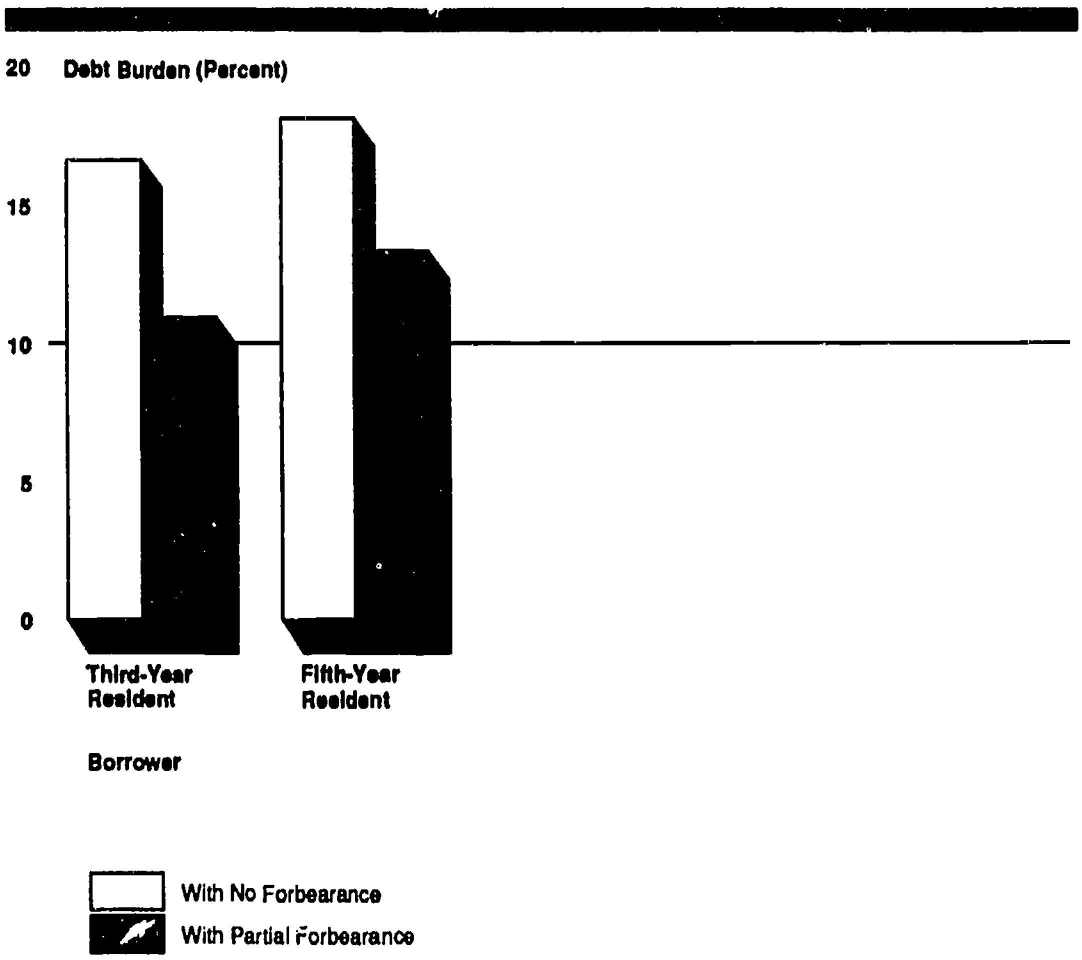
Lenders are not obligated to provide medical residents complete forbearance of Stafford loans. Although Public Law 101-239 provides residents with access to forbearance, neither it nor the Department regulations require complete forbearance. While partial forbearance reduces residents' loan payments, it does not provide adequate debt relief under our scenarios. To remedy this situation, the Department plans to revise its regulations to require that lenders honor residents' request for complete forbearance.

Our Analysis

Complete Forbearance Can Make Residents' Debt Burden More Manageable

Medical residents who are required to make principal and/or interest payments on their Stafford loans could incur financial hardship. Without forbearance, third- and fifth-year residents would spend about 17 and 18 percent, respectively, of gross income to repay their student loans—exceeding the Department's 10 percent level for manageable nonhousing debt. Similarly, while partial forbearance mitigates medical residents' debt burden, it may not shield them from financial hardship. Third- and fifth-year residents who pay only the interest portion on Stafford loans would still have debt burdens of about 11 and 13 percent of gross income, respectively (see fig. 2).

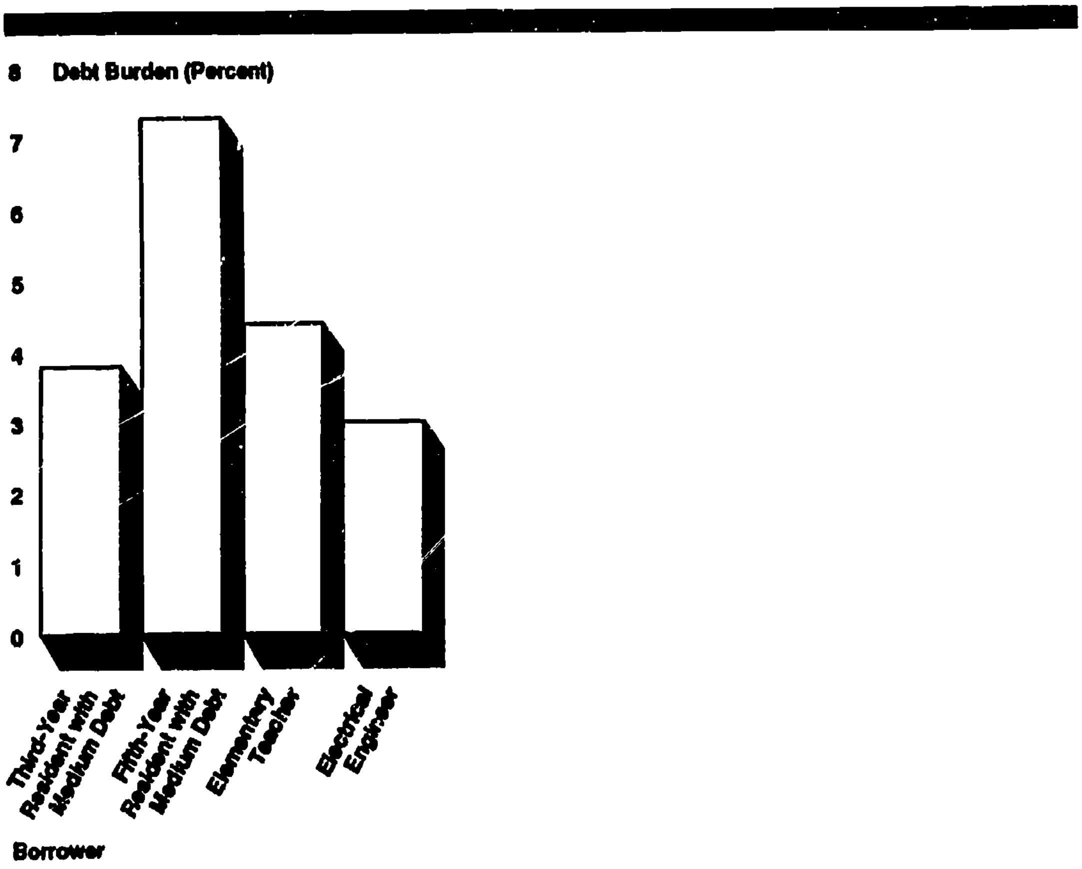
Figure 2: Debt Burden for Third- and Fifth-Year Residents Without Complete Forbearance



Note: Partial forbearance debt burden reflects payment of interest only.

When medical residents receive complete forbearance on their Stafford loans, their student loan payments drop to more manageable levels. Third- and fifth-year residents who obtain forbearance of both principal and interest payments would have debt burdens well below the hardship level—about 4 and 7 percent, respectively. Moreover, these debt burdens, which reflect student loan payments on loans other than Stafford loans, are comparable to those of other nonmedical borrowers, such as educators and engineers (see fig. 3).

Figure 3: Debt Burden for Residents With Complete Forbearance and for Nonmedical Borrowers



Postresidency Payments Are Still Manageable Despite Added Interest From Forbearance

Forbearance has a modest impact on residents' future student loan debt burdens. Interest that accumulates during forbearance is added to the original loan balance, thereby increasing postresidency loan payments. As a result, those completing a 3-year residency who received complete forbearance for 6 months (following the deferment and grace period) would increase their loan payments from $546 to $559 a month, an increase in debt burden from 8.5 to 8.7 percent. Those completing a 5-year residency who had complete forbearance for 2 years and 6 months would increase their loan payments from $546 to $615 a month, an increase in debt burden from 5.7 to 6.4 percent.

Consolidating Debt Can Provide Further Relief After Residency

Following their residencies, these borrowers can lower their loan payments by electing to consolidate Stafford and other eligible debt. As a result, monthly payments decrease, which results in a more manageable debt burden. For illustrative purposes, we used our medium debt scenario and assumed that the borrower obtained forbearance throughout residency and extended the repayment period to 20 years. In this case, general practitioners who consolidate eligible loans would reduce their monthly loan payments from $559 to $436 per month, lowering their debt burdens from 8.8 to 6.8 percent.[5]

Most residents who consolidate their loans can obtain additional debt relief by establishing a graduated repayment plan. Under such plans, borrowers pay only the interest on their debt during the early years of repayment, postponing principal payments until incomes are higher. For example, under a 4-year graduated repayment plan, a borrower pays only interest for the first 4 years and then pays principal and interest for the remaining term. A general practitioner who receives complete forbearance for 6 months and uses such a plan would have monthly loan payments of $383. This equates to a debt burden of about 6 percent in the first year of repayment. Thereafter, these former residents would pay both principal and interest; their monthly payments would increase to $466 but their debt burdens would be less because of salary growth.

Residents Are Not Guaranteed Access to Complete Forbearance

Although Public Law 101-239 requires lenders to honor residents' requests for forbearance, it does not specify that lenders render complete forbearance. The Department recognizes many types of forbearance in its regulations. For example, partial forbearance can reduce loan payments to only interest during residency. In contrast, complete forbearance postpones loan payments until after residency training. At present, the Department's regulations allow the lender to determine the type of forbearance residents will receive. According to financial aid administrators, some lenders do not make complete forbearance available to residents.

The Department plans to change its regulations regarding forbearance. In December of 1990, the Deputy Secretary of Education stated that the Department would revise its regulations to require that lenders permit forbearance of all principal and interest for medical and dental interns/residents. The Department hopes to add the forbearance amendment to a larger package of student loan regulations, which are being readied for final publication in early 1992. However, the Department has not yet determined whether it can insert the revision in the regulation package at this stage consistent with the Administrative Procedures Act. If the forbearance amendment is excluded from the regulation package, the rulemaking process must be started again. As we previously reported,

[5]Borrowers who consolidate their student loans, however, generally pay more in interest over the repayment period of the consolidated loan, and must balance this additional cost with the benefit of reduced monthly payments.

many recent Department regulations were not issued within established timeframes.[6] For 80 issued regulations we reviewed, the average issuance time was nearly 13 months. Until the Department clarifies its regulations to require that lenders honor residents' requests for complete forbearance, some residents may continue to have student loan payments that exceed 10 percent of their gross income.

Conclusions

Access to complete forbearance of Stafford loan payments would allow medical residents to reduce their student loan payments to a more manageable level until they begin their primary earning years. If further debt relief is needed after residency, physicians can lower their debt burdens by extending repayment schedules through loan consolidation and/or graduated repayment plans.

Currently, however, lenders are not required to grant complete forbearance to medical residents. Partial forbearance does not provide sufficient debt relief to many residents. Ensuring medical residents' access to complete forbearance would obviate the need to extend the current 2-year residency deferment. The Department's regulatory changes now underway would give residents the access to debt relief that is needed but could take from several months to several years to be promulgated.

Matter for Consideration by the Congress

The Congress should consider amending the Higher Education Act of 1965 to require that lenders grant medical residents' requests for complete forbearance of Stafford loan principal and interest payments. If enacted, medical residents would immediately have the option of obtaining complete forbearance.

As agreed with your offices, we did not obtain written agency comments on this report but we did obtain the views of officials at the Department of Education. They generally agreed with the report's contents, and we have incorporated their comments as appropriate. We are sending copies of this report to the Secretary of Education, other congressional committees, the Association of American Medical Colleges, and other interested parties.

[6] Education Regulations: Reasons for Delays in Issuance (GAO/HRD-91-4BR, Nov. 15, 1990).

This report was prepared under the direction of Franklin Frazier, Director, Education and Employment Issues, who can be reached on (202) 275-1793. Other major contributors to this report are listed in appendix V.

Lawrence H. Thompson

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Assistant Comptroller General

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Abbreviations

AAMC	Association of American Medical Colleges
CPC	College Placement Council, Incorporated
HEAL	Health Education Assistance Loan
HPSL	Health Professions Student Loan
IRS	Internal Revenue Service
PV	present value
SLS	Supplemental Loans for Students

Scope and Methodology

To make our assessment of repayment ability, we used educational indebtedness data for medical school graduates reported in the Association of American Medical Colleges' (AAMC) 1990 survey.[1] The survey respondents provided information on three student loan issues: (1) premedical school debt, (2) medical school debt, and (3) debt sources. AAMC was unwilling to provide the raw data; hence, we could not verify its accuracy. National data on debt for medical residents was not available from other sources. Therefore, we requested AAMC to generate descriptive statistics, specifically the 25th, 50th, and 75th percentiles of total debt. At our request, AAMC developed three bands of debt, which centered on these percentiles. We used the average value of graduates' debt falling within these bands—referred to as low, medium, and high debt scenarios—to calculate student loan payments. The total educational debt levels corresponding to these scenarios are $25,000, $40,000, and $60,000, respectively.

Based on discussions with financial aid officials at medical schools regarding the typical medical student's debt portfolio, we made the following assumptions regarding the medical residents in our scenarios:

- residents entered undergraduate school in September 1982, medical school in September 1986, and residency in July 1990;
- residents received student loans evenly throughout their 4 years of medical school; and
- residents elected to make no payments during school or deferment periods.

In addition, borrowers may have other conditions affecting their financial status, such as having dependents or a spouse with income. Because of variations in these conditions, we have not included them in our analysis. Table I.1 shows the interest rates on the various loans used in our loan payment calculations.

[1] AAMC's membership includes all American and Canadian medical schools and over 400 teaching hospitals.

Table I.1: Interest Rates Used to Calculate Loan Payments

Figures in percent

Loan	Interest rate
Stafford	8
Supplemental Loans for Students	12
Health Education Assistance Loans and other private loans[a]	12
Perkins	5
Health Professions Student Loans[b]	7
All other loans	8

[a]Generally, the interest rate on private loans was commensurate with the rate charge for HEAL.

[b]The interest rate on HPSLs changed from 9 to 5 percent midway through the survey respondents' medical school tenure. As such, we used the avorage of these rates in our calculations.

In calculating residents' debt burden (the ratio of payments to income), we used the median stipend reported by AAMC. This information, obtained from teaching hospitals, generally applies to the July 1990 to June 1991 year. To reflect future adjustments to resident salaries, we inflated these stipends by 4 percent for each additional year in residency.

To calculate postresidency debt burden, we used salary information collected by the American Medical Association. These data are based on earnings during the first year of practice for two specialties—general practitioners and general surgeons, which require 3- and 5-year residencies, respectively. We used two different specialties to reflect varying interest costs (because of longer periods of forbearance) and varying starting salaries. To project salaries prevailing when the residents would begin practice, we also inflated the 1986 salary values by 4 percent annually.

In comparing residents' repayment ability with other student borrowers, we chose two professions with divergent starting salaries—elementary education and electrical engineering. We obtained salary data for these two professions from a report published by the College Placement Council, Incorporated (CPC).[2] As shown in appendix IV, we also calculated income left after both the loan payment and federal income taxes. To make our federal income tax estimates, we used data published by the Internal Revenue Service (IRS) in its Statistics of Income Bulletin. We used IRS's data on federal taxes as a percentage of adjusted gross income and deducted that portion to reflect federal taxes that would be paid.

[2]CPC Salary Survey, September 1990.

In 1991, the Department of Education identified educational debt by broad categories of student majors.[3] As such, we used the debt reported for education majors and physical science majors for our hypothetical elementary teacher and electrical engineer, respectively. Because the report did not identify students' loan mix, debt may include a combination of low and high interest rate loans. For our purposes, we assumed all loans were Stafford loans.

Present Value Analysis

We also analyzed medical school graduates' debt burden in present value (PV) terms to measure the long-term implications of their educational indebtedness.[4] After completing their residency, physicians experience substantial salary increases. As this occurs, the burden of their student loan payments becomes smaller. Our cash flow analysis—which measured the debt burden during residency—overstates the average burden faced by medical doctors while repaying their student loans. In comparing the PV of both future loan payments and physicians' earnings, we can determine whether their debt burdens are manageable on average.

We made the PV calculations for medical residents who would become general practitioners and surgeons, which require 3- and 5-year residencies, respectively. We used an earnings growth formula to make salary growth projections.[5] We discounted future dollars using a 6-percent real discount rate. This conservatively high discount rate approximates the opportunity cost of funds for physicians.[6]

Our PV calculations used analysis periods that approximate the debt repayment schedule on two student loans typically borrowed by medical students. One period reflects the debt burden physicians face during the repayment schedule of Stafford loans—10 years. The other reflects the debt burden incurred during repayment of HEAL—25 years.

[3] Debt Burden Facing College Graduates, prepared under contract for the U.S. Department of Education, February 1991.

[4] This concept is based upon the time value of money and provides a way to combine and compare dollar amounts received in different time periods. The PV of a future cash receipt is the amount of money that an investor would pay today for the right to receive that future receipt.

[5] We used a formula from "Wage Determinants: A Survey and Reinterpretation of Human Capital Earnings Functions," in Robert J. Willis, Handbook of Labor Economics, Vol. 1, 1986.

[6] The 6-percent real discount rate was chosen as a conservatively high approximation of the opportunity cost of funds to physicians. In addition, we calculated the present value using a substantially lower discount rate—2 percent—to approximate the individual physicians' rate of time preference. Such a rate slightly reduces the long-term burden.

Residents' long-term educational debt burden is well within the Department of Education's manageable debt range when expressed in PV terms.[7] In these terms, general practitioners and general surgeons would have debt burdens of

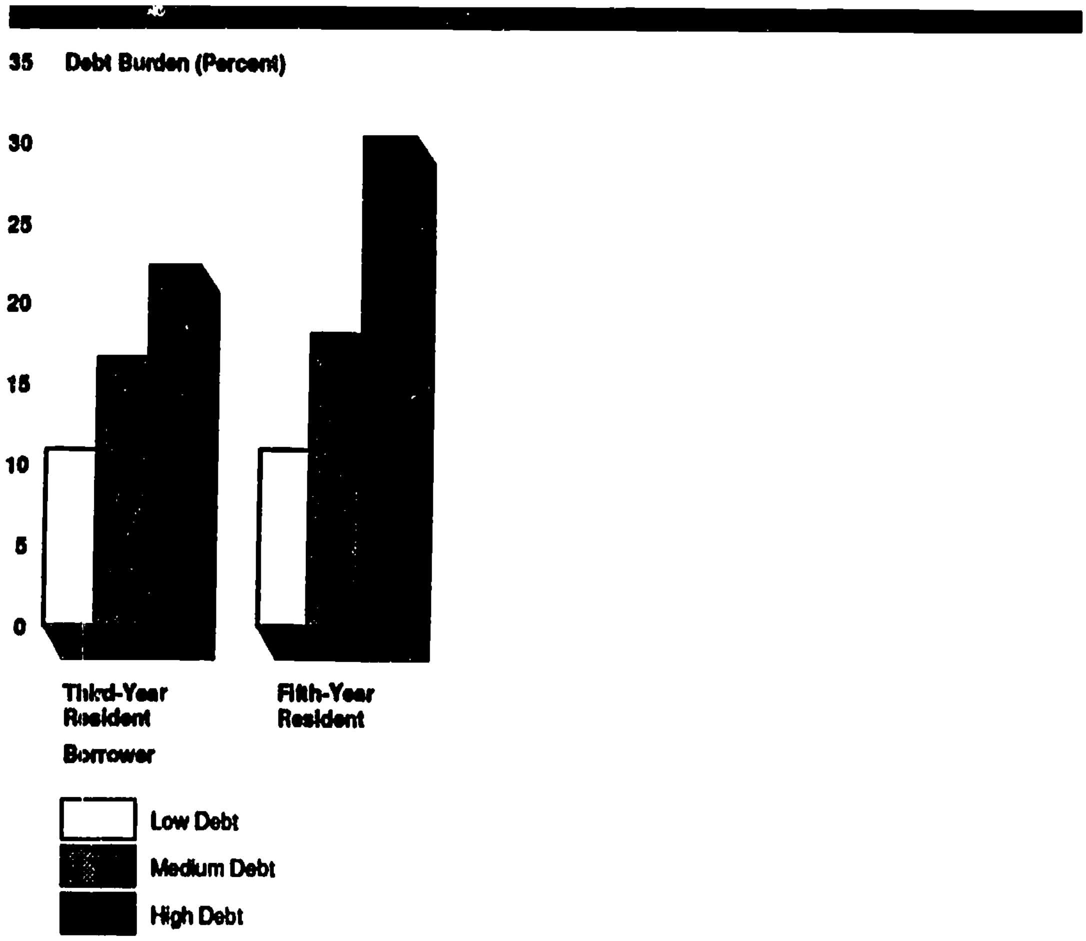
- 5.5 and 3.7 percent, respectively, during repayment of Stafford loans and
- 2.9 and 2.1 percent, respectively, during repayment of HEAL.

Throughout the review, we discussed loan provisions and procedures with representatives from the Department of Education, AAMC, a guaranty agency, a loan servicer, several medical school financial aid offices, and the Student Loan Marketing Association.

We performed our work between October 1990 and September 1991 in accordance with generally accepted government auditing standards.

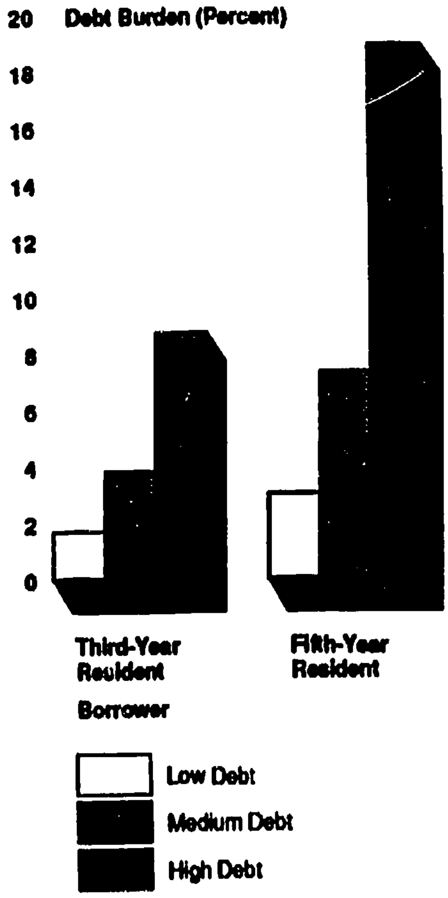
[7]For these scenarios we assumed that these borrowers received complete forbearance of Stafford loans during their residencies.

Debt Burden for Third- and Fifth-Year Residents Without Forbearance



Note: Debt burden reflects no forbearance of Stafford loan.

Debt Burden for Residents With Complete Forbearance



Note: Debt burden reflects complete forbearance of Stafford portion of loan.

Student Loan Payments Under Various Scenarios

Borrower	Debt level	Salary	Monthly Loan payment	Income remaining	Debt burden (percent)
Medical					
Third-year resident:					
With no forbearance	Low	$2,543	$277	$2,014	10.9
	Medium	2,543	423	1,869	16.6
	High	2,543	566	1,725	22.3
With partial forbearance[a]	Low	2,543	172	2,119	6.8
	Medium	2,543	276	2,015	10.9
	High	2,543	411	1,881	16 2
With complete forbearance[b]	Low	2,543	44	2,248	1.7
	Medium	2,543	97	2,194	3.8
	High	2,543	221	2,070	8.7
Fifth-year resident:					
With no forbearance	Low	3,012	328	2,361	10.9
	Medium	3,012	546	2,144	18.1
	High	3,012	915	1,774	30.4
With partial forbearance[a]	Low	3,012	223	2,470	7.4
	Medium	3,012	399	2,291	13.2
	High	3,012	760	1,930	25.2
With complete forbearance[b]	Low	3,012	95	2,599	3.1
	Medium	3,012	220	2,469	7.3
	High	3,012	570	2,120	18.9
First-year postresidency:					
General practitioner[c]	Low	6,387	328	4,992	5.1
	Medium	6,387	559	4,761	8.8
	High	6,387	929	4,391	14.5
General surgeon[c]	Low	9,560	378	7,241	4.0
	Medium	9,560	615	7,004	6.4
	High	9,560	989	6,630	10.3
Nonmedical					
Elementary educator	Medium	1,512	69	1,387	4.4
Electrical engineer	Medium	2,648	79	2,307	3.0

Note: Income remaining is after federal income taxes and student loan payments.

[a]Paying interest only on Stafford loan.

[b]No Stafford loan payment.

[c]Who had complete forbearance during residency.

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