How to Manage Law School Debt
Sarah Kellogg, Newhouse News Service

Introducing the topic of personal debt at a dinner party can kill even the most vibrant discussion, prompting awkward silences, sidelong glances, and a quick trip to the buffet table. Not so if you’re talking to a newly minted attorney.

Ask a first-year associate about personal debt and you’re likely to be regaled with tales of six-figure student loans that rival home mortgages. New lawyers say they don’t talk about the mountain of debt that blocks their view of a future with stock portfolios and vacation homes, they’d likely end up in the fetal position.

Law school debt is both a badge of honor and a nightmare-inducing burden. It’s also a fact of life.

As law school tuition rose dramatically in the 1990s, student loan debt climbed to new heights as well. In the 1992-93 academic year, a graduating student left law school with $37,637, on average, in debt. By 1999-2000 it was $67,300, according to the American Bar Association (ABA) Commission on Loan Repayment and Forgiveness.

You don’t realize how much you’re going to be in debt in school. It’s not real until you get out and you get these bills and you start dealing with it,” says Melanie Ohlman, a 2003 American University Washington College of Law graduate who took out more than $110,000 in graduate education and law school loans. “Then all of a sudden, it’s there and in your face. It’s very real, and you’re not quite sure what to do about it.”

Law students aren’t the only ones worried about what some feel is fast becoming a debt crisis. Lifting the Burden: Law Student Debt as a Barrier to Public Service, released last summer by the ABA commission, concluded that mounting debt has resulted in fewer new lawyers choosing to go into government service or taking public interest jobs. The reason? Too much debt and too little income.

In 2002, according to the National Association for Law Placement, the median starting salary in private practice was $90,000. For government attorneys it was $42,000. For those working in public interest professions, salaries were even lower, topping off at $36,000 annually. Even the most skilled financial whiz, experts say, would have a hard time making ends meet on a $40,000 annual salary while paying

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$1,000 in rent and $700 in loan payments every month.

"Some students come in for counseling and they say they're going to have to get a really big job because they have this really big debt," says Carole Montgomery, associate director of the career development office at the George Washington University Law School. "It is not uncommon to see $90,000 or $100,000 debts these days. We spend a lot of time trying to calm their fears, and they're not illegal debts. Anyone would be worried about a debt that size. Basically they've got a mortgage but no house to show for it."

Calming fears and drawing a blueprint to solvency in the face of this level of debt is a challenge. Though it may seem imposing, law school loans are manageable, and can even work in your favor if properly handled. After all, said the government, the bank, and your law school didn't approve their loans without assessing the risks.

A law degree is a good investment. The key is making sure that the investment isn't spoiled by ignorance or bad choices that translate into late payments and defaults.

"As a general rule, we don't worry as much about our heavily indebted borrowers," says Patricia Scherschel, chief loan consolidation executive at Sallie Mae, one of the nation's largest student loan providers. "The less you owe, the more likely you are to default. The more you owe, the more likely you are to not default, because you have more education. The more education you have, the more likely you are to earn more in your work life."

Earning more, saving more, and paying your bills is the key to any successful debt management strategy. Advice is plentiful on how best to do all three. Washington Lawyer asked the experts financial planners, lenders, and savvy graduates for their tips. Some of them are simple. others require work.

If you're a law student educating yourself, a young lawyer, or a young lawyer confronting a mountain of loan debt, here are a few simple steps that can ease your burden and set you on the path to solvency. What you're likely to find out is that the path out of debt may be shorter and less arduous than you think.

Know Your Loan

You don't have to be a financial planner to know that the first step in successfully managing debt is assessing the landscape. Law school counselors say too many students sign their promissory notes and then file them away in a box in the closet, stuck between pizza coupons and cell phone bills.

Law school loans come in a number of varieties, but the most important distinction is determining whether they are government-guaranteed or private loans. Private loans generally have higher interest rates and often lack the flexibility that comes with government loans, such as Stafford and Perkins loans.

Private loans have their advantages. Of course, it's easier to get approval for them, as private institutions are the lender of last resort (not counting Mom and Dad), and they generally have no limit on the size of the loan if you're a creditworthy borrower.

Stafford loans are the go-to lending vehicle for most undergraduate and graduate students in the United States. Distributed via the federal government (Direct Loans) or through banks and credit unions (Federal Family Education Loan, or FFEL), Stafford loans provide students with the most freedom and cash. Each academic year an eligible student can qualify for up to $10,500 in loans (only $8,500 may be subsidized Stafford loans), with an overall maximum of $138,500 for graduate and undergraduate work. There are two types of Stafford loans: those subsidized by the government, which pays the interest on the loan while you're in school, and those unsubsidized. Unsubsidized loans are awarded based on demonstrated need, whereas unsubsidized loans are available to all students.

The advantages of choosing a Stafford loan are many: long repayment periods, low interest rates, and special deferments. Interest rates have been spectacularly low for the last few years, and federal loan rates have reflected that trend.

Perkins loans—federal loans given to borrowers with extreme financial need—come with many of the same borrower-friendly provisions as the Stafford loans. They also have a much-valued forgiveness provision. A lawyer in public service, such as work-
ing as a prosecutor or in a child services agency, may qualify to have a portion of his or her loan forgiven by the federal government. Your law school loan officer is the best contact to find out whether you’re eligible for the forgiveness program.

For more information on federal loans and to use the U.S. Department of Education’s loan calculator, visit http://studentaid.ed.gov.

In short, all loans aren’t created equal. The types of loans a law student acquires could impact on future career choices and determine what path to take when paying them off. So, as a first step, do some research before signing on the dotted line. The easiest loan to obtain is often not the best, and bad choices have long-term consequences.

Do the Math

Upon leaving law school, young lawyers face the next step: paying back the institutions that financed their education. While you’re sorting through your loan papers, experts say, you should review your own personal finances.

You need to get down to the basics, as in budgeting and financial planning. What is your take home salary? How much do you spend? Are you a three-latte-a-day person with a penchant for fresh-cut flowers? Or do you live in a group house with six acquaintances and clip coupons for shampoo and toothpaste?

Financial planners say knowing your spending habits is the first step toward eliminating debt. Without realizing it, many young professionals burn through hundreds of dollars a month on meals and entertainment. That is especially true of recent graduates who are seeing their first paychecks after years of student living.

Them Khinn, a Northern Virginia financial advisor, recommends that you stay away from the trappings of what some consider a successful law career: expensive cars, designer clothes, and a Georgetown home address. Live like a student, even if you’ve snagged a six-figure job at a top law firm.

“It’s natural for human beings to go out and entertain themselves and their friends,” says Khinn. “People in their twenties tend to do an awful lot more of that than older people. What they really need to do is cut out that third drink at the bar or not order a second pizza that week. It’s about living a humble existence.”

There are creative ways to cut corners, and wholeheartedly embracing cost cutting is a fantastic debt strategy. Guidance on frugal living, from coupon clipping to tips on buying quality used cars, can be found at www.frugalcorner.com.

“The important thing is to get into the habit of saving those monthly loan repayment checks,” says Khinn. “Once you get into the habit of doing it, it’s much easier.”

Pay Down the Principal

Rob Kimm, a rising third-year law student at George Washington University, has a plan, even if it will be 12 months before he can put it into effect.

Kimm, who would like to snag a legal commentator job on cable television analyzing the latest celebrity legal case, says he may sell his soul for a couple of years to a major law firm to pay down the debt. Though the work would be blistering, the payoff could be huge.

“I could knock out half or more of my loan in two or three years by working at a big law firm,” says Kimm, who expects to have about $80,000 in debt when he graduates. “After I pay off my debt, I won’t be one of those people with the golden handcuffs. I’ll switch over and do what my heart desires.”

With all the savings from maintaining a modest lifestyle, you can prepay your student loans at a faster pace. Money spent today paying down a loan debt can eliminate tens of thousands of dollars in interest costs over the life of the loan. Most lenders allow you to prepay federal and private loans without penalty.

Additionally, some lenders offer repayment perks for borrowers with a good track record of either paying on time or signing up for automatic debit of payments from their checking or savings account. After making the first 33 monthly payments on time to Nellie Mae, a student loan provider, a borrower receives a credit totaling 3.3 percent of his or her original Stafford loan balance.

If your payment exceeds the minimum amount due, be sure to include a note with the payment state-
ing that the overpayment is to be applied to principal only. And remember, it's important to keep tabs on the lender. Renee Green, a financial adviser in Tysons Corner, Virginia, notes that lenders do make mistakes.

"Make your monthly payments on time, but make sure to double-check the balance at least once a year," says Green. "The key is making sure your payments are going toward the loan. Your goal is to see that the principle goes down as fast as possible. You have to look for an advantage at every turn."

**Consolidate to Save**

Consolidating loans won't eliminate monster debt overnight, but it can ease your level of pain almost immediately. Consolidation is a must for borrowers who want to lock in low interest rates, who have high monthly payments, or who have several loans from multiple lenders. Loan consolidation is allowed only once, unless you go back to school again, so it's important to choose wisely.

With consolidation, existing loans are paid off and replaced with one loan at a fixed rate, which is based on a weighted average of the interest rates from your original loans. (Interest rates are capped at 8.5 percent on federal consolidation loans.) But a word of advice: the best time to consolidate loans is during the six-month grace period following your graduation from law school. Interest rates for loans consolidated during your grace period are 2.875 percent, versus 3.375 percent for those consolidated after you've entered repayment.

"I speak fairly often to graduating law students," says Scharf. "They are very relieved when I tell them that consolidation can help them cut their monthly payment in half. They can take longer to repay. Consolidation is a very practical debt management tool for most borrowers."

Fans of consolidation say its strength is the freedom it gives cash-strapped borrowers to stretch their repayment periods from the traditional 10 to 30 years. With interest rates inching back up, the fixed low-interest rates on consolidation loans will guarantee tens of thousands of dollars in savings as well.

Borrowers may also sign up for graduated repayment plans that keep payments to a minimum in the first two or three years of the loan and increase in later years. For example, a borrower with $80,000 in debt at an interest rate of 2.87 percent would pay $192 in monthly loan payments in the first three years of the loan, under the graduated repayment plan. Those in the standard repayment program would pay $332 a month. Of course, the graduated plan costs you more ($122,018) over 30 years than the standard plan ($119,489).

"This is truly like locking in a 30-year mortgage," says Michael Beriss, a financial adviser in Bethesda, Maryland. "I don't think there is anything wrong with paying off a loan over a longer period of time. If you're good at investing, you can make more money on your money than the financial cost of borrowing at these low interest rates. But if you just spend the money instead of investing it, then you should keep the payments higher and pay off your student loan."

Where you go to consolidate Stafford loans depends on whether they are Direct or FFEL loans. Check with your original lender if you received a FFEL loan. Graduates of Direct-lending schools should visit the Education Department's consolidation Web site at http://loansconsolidation.ed.gov.

It follows that consolidating private student loans into a single umbrella loan to take advantage of lower interest rates and long repayment periods makes sense as well. What doesn't work is combining private and federal loans. For a number of reasons, experts counsel against it. You can't forbear payments in cases of economic hardship. If you want to go back to school, you can defer loan payments as you can with federal loan consolidation, and you can't claim the tax deduction for interest on your loan. Finally, in the event you die, federal loans are forgiven, whereas private ones are not.

"It's an entirely different animal," says Beriss. "That's what is so attractive about federal loan consolidation. It caters to the borrower."

For those considering wrapping up their debt with their home mortgages, planners counsel caution. Your home mortgage lacks the wriggle room you might need later if your fortunes change, so you would forgo any special deferments on loan payments given in cases of hardship.

"The only true danger with taking equity out of
your home to pay off debt is, if you fail to maintain the discipline of making those payments, there is a problem,” says Victor DiBattista, a certified financial planner in Ellicott City, Maryland. “Miss a payment and they can foreclose on your house.”

Consolidation comes with its own baggage. You generally pay more over the life of the loan, and you could lose some of the benefits afforded borrowers under your original loan, such as deferments due to disability or loan forgiveness in exchange for public interest work. That is why loan experts recommend against consolidating Perkins loans if you plan on entering the Peace Corps or taking a public service post.

Finally, don’t merge your student debt with your wife’s or husband’s loans. Entwining your lives and your debt only sounds romantic, experts say. Debt can last longer than many marriages, and a number of couples have found themselves in divorce court haggling over who should pay what loans. If your spouse happens to skip town, you could end up being liable for all the debt.

Knock Out Debt With LRAPs

Okay, you’ve locked in the best rates you can by consolidating your loans, and you’re still struggling with your monthly payments. What do you do next? Financial aid advisers say it’s time for you to check out Loan Repayment Assistance Programs, or LRAPs.

LRAPs are largely funded by law schools, although the federal government, the states, and the private sector are jumping on board. Their purpose is to underwrite loan repayments for government and public interest lawyers earning substantially lower wages than they could in private practice.

“This is a great way not only to recruit but to retain attorneys in what can be hard-to-fill jobs,” says Marc Mulvenon, program manager for research at Equal Justice Works, which champions financial assistance for new attorneys. “Eighty-one law schools do have some type of loan repayment assistance program. That’s a significant increase from 2000 when only 47 schools had them.”

LRAPs do have their limits. Most are severely underfunded, and earning $1 above the salary limit, which generally hovers at $40,000, will get you boot ed out of most programs.

In the Washington metropolitan area, Georgetown University’s Loan Repayment Assistance Program is the granddaddy LRAP. Started in 1986, the program, through two components, reduces the financial burdens of Georgetown’s recent graduates who pursue careers in public service through no-interest loans and loan forgiveness.

The first component, LRAP I, awards interest-free loans to attorneys who are providing legal services to low-income clients through legal assistance programs or public defender offices. The awards eventually convert to grants. After five years in the program, LRAP financial assistance is completely forgiven. Those who leave the program before the five years are up have a percentage of their loans forgiven, based on their length of time in the program, and must repay the rest to the university.

The other component, LRAP II, awards six-month loans to graduates who are providing legal services on behalf of the public in county prosecutor or district attorney offices. At the completion of the six months, the loans are forgiven. LRAP II dollars are appropriated based on the amount of money available and the number of eligible applicants. More awardees translate into fewer dollars for candidates.

Along with Georgetown, the law schools at American University and George Washington University, as well as the University of Maryland School of Law, offer LRAP benefits to alumni. The Catholic University of America Columbus School of Law will begin offering LRAP benefits in 2005, and Howard University School of Law is looking into starting one.

For Melanie Ohant, LRAP has been a lifesaver. She receives support through a fellowship from Equal Justice Works and American University’s Public Interest Loan Repayment Assistance Program. As an attorney at Ayuda, Inc., which provides legal aid to refugees and individuals brought here to perform forced labor, she makes less than $40,000 annually.

“My fellowship comes with an amazing loan forgiveness program,” says Ohant. “You cannot live on the little amount of money you get paid at a nonprofit.
Pursue Government LRAPs

Worried about impending retirements, the federal government has embraced LRAPs in recent years, seeing them as a way to recruit talented attorneys and other staff into government service.

The Office of Personnel Management's May 2004 report to Congress on federal LRAPs describes a flourishing network of assistance programs. In fiscal 2003, 24 agencies provided LRAP benefits to nearly 2,100 employees at a cost of $9.1 million. The Federal Employee Student Loan Assistance Act of 2003 increased the maximum annual grant from $6,000 to $10,000 for any one employee during a single year. The law also increased the lifetime cap on benefits from $40,000 to $60,000.

"More work still needs to be done here," says Mulvenon. "Once the programs are established, the agencies have a hard time funding them. They may be able to help only two or three students. Or they set the eligibility requirements so tightly that few people can qualify. It's disappointing because LRAPs really hold out some hope for keeping young lawyers in public service and out of major debt."

If you're working in the federal government now, your best chance of capitalizing on the program is contacting the Office of Personnel Management or the benefits' office within your agency or department. Each agency puts its own special mark on its program, so it's important to find out all the details before applying.

Take the U.S. Department of Justice. There eligible attorneys must have at least $10,000 in debt and commit to a three-year service agreement to receive awards of up to $10,000 each year. Political appointees are excluded from the program. In 2003 the agency provided more than $688,000 in loan repayments to 160 employees.

The states are cultivating their own programs as well. Nine states, including Maryland, offer LRAP benefits for their residents. In Maryland the Janet L. Hoffman Loan Assistance Repayment Program provides up to $7,500 in loan subsidies annually for graduates of Maryland colleges or law schools. To quality, your gross salary cannot exceed $50,000 ($710,000 for couples), and you must be employed full-time in state or local government or a nonprofit organization serving low-income residents. The program is open to Maryland residents in a number of professions, including the law, nursing, social work, and teaching. For more information on the Hoffman LRAP, visit www.mhec.state.md.us.

Nonprofits are coming around to the benefits of LRAPs. A handful of them nationally offer LRAP benefits to their staffs. A trip to the human resources department might just turn out to be a boon for you and your company or organization.

Mulvenon says that as more and more employers find it difficult to keep highly skilled employees, especially attorneys, there will be even more interest in creating programs such as LRAPs. More importantly, an ambitious attorney might be the impetus to start such a program.

"I'd really encourage them to go in and make the pitch for it," says Mulvenon. "You never know what can happen."

Take a Tax Break

Even if your law school and employer don't offer LRAPs, you may be able to qualify for a popular federal income tax deduction. The Student Loan Interest Deduction allows you to deduct up to $2,500 of the interest you pay each year on your student loans.

To be eligible for the federal income tax deduction, the loans must have been used for educational purposes. The Internal Revenue Service phases out the deduction as taxpayers' individual earnings exceed $50,000 ($70,000 for married taxpayers filing jointly). It is completely eliminated for taxpayers earning $65,000 or more annually ($130,000 for couples filing jointly). The good news is your lender is charged with sending you the proper form (a 1098-E) if you paid more than $600 in interest in a calendar year, so the burden isn't on you alone to take advantage of the deduction.
Keep It in Perspective

Andrew Stewart has a message for stressed-out, debt-swamped lawyers: relax and move forward.

Stewart has been on his own career track since graduating in 2003 from George Washington University. After graduation he moved to Oregon to take the bar (he passed it), then quickly returned to Washington and submitted a waiver application for the D.C. Bar, which is still pending. Taking a legal temping job at $27 an hour, Stewart became financially secure enough to pay his bills while he studied for the Virginia bar (results pending).

Stewart works 50 hours a week, earning time and a half for 10 of those hours. He's doing better than many of his law school friends. Though facing $100,000 in debt, he's not running scared. In reality, he's embracing the idea.

"The nice thing is I'm pretty much judgment proof," says Stewart. "I'm insolvent. If I were to sell everything I owned, I wouldn't have close to what I needed to pay off my debts. But you can't think of it that way. It's really an investment in your future. When you think about it as an investment, it's a little bit easier to stomach."

But Steven Schoener, an associate professor of law at George Washington University, hopes that his former students aren't growing so accustomed to their massive debts that they lose respect for the marginal debt, such as credit card debt and automobile loans. After all, debt is serious business.

"The phenomenon I find the most troubling is the numbers have become so big," says Schoener, "Students lose respect for marginal debt when they're contemplating $150,000 or $200,000 in debt. I think most faculty would talk to today get the sense that students don't get that old adage, 'Live like a student now, so you can live like a lawyer forever.' Today it's live like a lawyer now [when you're in college], so you can live like a student forever."

Meet the Challenge

Although there is always a chance you might win the Powerball lottery, or a wealthy aunt will leave you $200,000 and the keys to her Porsche, the reality is five years from now many young lawyers will be in debt. Ten or 15 years from now many will still be in debt. It's the life you've chosen, but it doesn't have to overwhelm you.

Financial planners say you should think of the next few years as a test of your skills and drive, no different from the years spent in law school. This time around you're not learning a profession. You're proving that you're capable of managing a debt burden that would sink souls with lesser prospects.

"Once you succeed here, it's pretty hard to imagine that any other financial problem would block your path," says Green. "It will take the same kind of ambition and determination that got you through law school, but you've already proven you've got the stuff."

And to think, it all starts with writing a check and putting it in the mail every month. From simple acts come great opportunities.