CHAPTER 6

Debt Management

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"Misers are no fun to live with, but they make great ancestors."
– Tom Snyder

This chapter is written from the perspective of providing good advice to students about management of student debt, although the principles included in this chapter are exactly the same as would apply for those starting or managing a practice of optometry (e.g., the discussion of cash flow analysis). In today's world, most people are sure to incur debt throughout their life. The cost of optometry school tuition, fees, equipment, and living expenses is such that most students will graduate owing a significant amount of money in student educational loans. According to the Association of Schools and Colleges of Optometry (ASCO), the graduating class of 2008 at all schools and colleges of optometry owed an average of $125,685 in student debt. Besides paying for education, one can expect to borrow money to begin practice, buy a car, and buy a house, as well as use credit cards. This chapter covers concepts on finance that can enable the optometric student, as well as an optometrist in practice, to best manage money.

MANAGING DEBT WHILE IN OPTOMETRY SCHOOL

To manage debt while in optometry school, students will need to learn about loans available for this type of education, how to calculate how much is needed to borrow, determine where expenses can be reduced, and calculate when loan money should be obtained. It is wise to also learn how to avoid mistakes others make that result in financial difficulties upon graduation.

Loan Programs Available to Finance Education

There are four federal low-interest rate loans available for optometric education: Federal Subsidized Stafford loans, Unsubsidized Stafford loans, Subsidized Perkins loans, and Subsidized Health Professions Student loans. In addition to these low-interest loans, there are two types of credit-based loans available at higher interest rates and fees: federal loans and private loans for students.

Federal Stafford loans are fixed-rate student loans for graduate students attending a college or university at least half-time. Stafford loans are the most common and one of the lowest-cost programs used to pay for school. There are two different types of graduate federal student loans: the Subsidized Stafford loan and the Unsubsidized Stafford loan.

Subsidized Stafford loans are awarded to graduate students based on financial need. Interest will not be charged before the repayment process begins or during periods of deferment. The federal government "subsidizes" the interest during these times. Unsubsidized Stafford loans are not awarded based on financial need. Any eligible graduate student can obtain Unsubsidized Stafford loans. Interest will be charged from the time the loan is disbursed to the time the loan is repaid in full. Graduate Stafford loans (both subsidized and unsubsidized) have a fixed interest rate of 6.8% through 2013.

The Stafford loan program funds the majority of the cost of education. As of 2009, annual loan limits are $8,500 for the Subsidized Stafford loan—first through fourth years, plus $32,000 for the Unsubsidized Stafford loan—first and second years, or $38,667 for the Unsubsidized Stafford loan—third and fourth years. Stafford lenders currently charge a 1% origination fee, and most guarantors charge a 1% default fee. An origination fee is a payment associated with the establishment of an account with a bank handling the processing associated with taking out a loan. The origination fee usually varies from 0.5% (half a point) to 2% (two points) of a given loan amount.

A federal Perkins loan is a low-interest (5%) subsidized loan for both undergraduate and graduate students with financial need. Each school or college of optometry is the lender. The loan is made using government funds, and the school or college contributes a share. The student must repay this loan to the school or college. Depending on when the student applies, the level of need, and the school's funding level, you can borrow up to $6,000 for each year of graduate or professional study. The total amount you can borrow as a graduate/professional student is $40,000, including any federal Perkins loans borrowed as an undergraduate. The amount of Perkins loans made available varies from school to school. For example, at the Southern California College of Optometry (SCCO), during the academic year 2008-2009 the Perkins loan program was able to provide $1,500 loans. At the University of California, Berkeley, School of Optometry, the Perkins loan program is able to provide loans to entering optometry school students that vary annually between $3,000 and $5,000.

The Health Professions Student loan program provides long-term, low-interest rate loans to full-time, financially needy students. At SCCO during the academic year 2008-2009, 35% received this subsidized loan for $2,500. The interest rate on this program is 5%. Parent income and asset information is required for this program.

There are two types of credit-based loans. One is federal and has an interest rate of 8.5% fixed with a 3% origination fee. The other source is a private student loan. This loan is set at a variable rate based on the strength of the borrower and co-borrower's credit scores, currently 8% to 10%. Very few lenders participate in private student lending and an increasing number of students do not pass the credit check for either of these credit–based loans.

Based on this information, it is advisable to borrow the 5% interest rate subsidized Perkins and Health Professions loans first, followed by the 6.8% Subsidized Stafford loan, and then the 6.8% Unsubsidized Stafford loan. Only borrow from the credit-based federal loan at 8.5% with 3% origination fee if necessary. Try to avoid the high-interest rate, credit-based private student loans altogether if possible.

How Much Should a Student Borrow for Optometry School?

Students should borrow the least amount of money needed for education unless interest rates are low enough to get a higher return on a safe investment, such as a certificate of deposit (CD), with any excess funds borrowed.

Those who borrow money to finance assets that will bring in more money know that borrowing the least amount of money at the lowest interest rate will result in the asset costing them less. The International Accounting Standards Board defines an asset as "a resource controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise." It is everything of value owned by a person or company. Buying an education, such as a Doctor of Optometry (OD) degree, is purchasing an intangible asset. An intangible asset lacks physical substance but has value. The amount paid for the asset of an OD degree will vary from student to student even within the same school. This occurs because there are variable expenses that occur in the cost of education such as food and loan interest. Many times the money needed exceeds the amount of low-interest federal loans available. Credit-based, high-interest rate loans must now be used by students who need the full cost of education funded. It follows that the least amount paid for the asset of your degree, the more you will have to invest in future enterprises such as starting or purchasing a practice.

There are times when one may wish to borrow as much money as possible through student loans. If the interest rate is very low, such as 2%, and the excess money borrowed can be put in a CD returning an excess of 2%, it makes sense to borrow the excess money and save it for future investments

upon graduation. Business loans for optometric practices are typically 2% over the prime lending rate.

The prime lending rate is the interest rate charged by banks to their most creditworthy customers (usually the most prominent and stable business customers). The rate is almost always the same among major banks. Adjustments to the prime rate are made by banks at the same time, although the prime rate does not adjust on any regular basis. The prime rate is usually adjusted at the same time and in correlation to the adjustments of the federal funds rate. The rates reported are based on the prime rates on the first day of each respective month. Some banks use the name "reference rate" or "base lending rate" to refer to their prime lending rate. A historic graph of the prime rate for the years 1999-2009 based on data from the Federal Reserve Board can be found in Figure 6-1 . Monthto- month changes in recent years is tabulated in Table 6-1.

To pay the least for an optometric education and have more funds for future investment; the student needs to borrow the least amount of money necessary at the lowest interest rates possible. To know how much to borrow, the student must be able to calculate the costs of his or her education.

CALCULATE THE COSTS OF AN OPTOMETRIC EDUCATION

Optometry schools have financial aid offices that will provide the optometric student with an estimate of living costs and educational costs for the four years in optometry school. This information can be an early guide that can be used to keep track of all expenditures and to aid in seeing where costs can be reduced. Table 6-2 outlines the estimated costs for attending an optometry school in an urban area for the class beginning in academic year 2008–2009 and proceeding through the four-year curriculum.

As the individual student researches the costs associated with attending college, it is important to recognize that some costs are "fixed" and will cost the same to everyone, whereas others are "variable" or under one's control. Keeping a record of all expenditures will allow a determination of how much less or more will be spent from the estimated costs furnished by the school or college of optometry. A record of financial

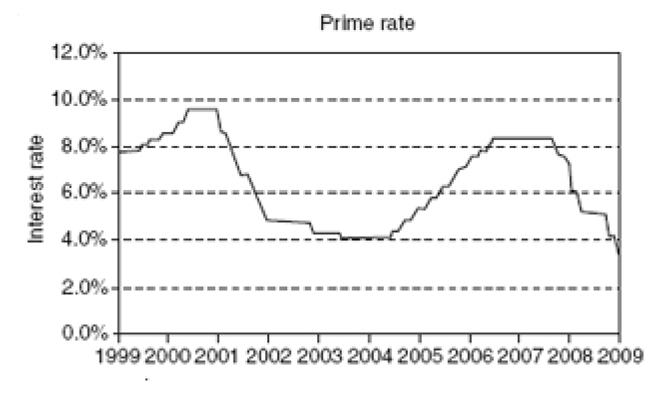

FIGURE 6-1 Graph depicting the prime lending rate in the years 1999–2009. (From MoneyCafe.com Copyright 2009)

TABLE 6-1

Month-to-Month Prime Lending Rate Changes

	Prime Rate										
Month/Day	1998 (%)	1999 (%)	2000 (%)	2001 (%)	2002 (%)	2003 (%)	2004 (%)	2005 (%)	2006 (%)	2007 (%)	2008 (%)
Jan 1	8.50	7.75	8.50	9.50	4.75	4.25	4.00	5.25	7.25	8.25	7.25
Feb 1	8.50	7.75	8.50	8.50	4.75	4.25	4.00	5.25	7.50	8.25	6.00
Mar 1	8.50	7.75	8.75	8.50	4.75	4.25	4.00	5.50	7.50	8.25	6.00
Apr 1	8.50	7.75	9.00	8.00	4.75	4.25	4.00	5.75	7.75	8.25	5.25
May 1	8.50	7.75	9.00	7.50	4.75	4.25	4.00	5.75	7.75	8.25	5.00
Jun 1	8.50	7.75	9.50	7.00	4.75	4.25	4.00	6.00	8.00	8.25	5.00
July 1	8.50	8.00	9.50	6.75	4.75	4.00	4.25	6.25	8.25	8.25	5.00
Aug 1	8.50	8.00	9.50	6.75	4.75	4.00	4.25	6.25	8.25	8.25	5.00
Sep 1	8.50	8.25	9.50	6.50	4.75	4.00	4.50	6.50	8.25	8.25	5.00
Oct 1	8.25	8.25	9.50	6.00	4.75	4.00	4.75	6.75	8.25	7.75	5.00
Nov 1	8.00	8.25	9.50	5.50	4.75	4.00	4.75	7.00	8.25	7.50	4.00
Dec 1	7.75	8.50	9.50	5.00	4.25	4.00	5.00	7.00	8.25	7.50	4.00

From Federal Reserve Board. Copyright 2008 MoneyCafe.com.

transactions is known as a General Ledger. Accounting programs for computers, such as Quicken or QuickBooks, are simple systems to see where the money is going. A manual paper spreadsheet can also be used to determine how much money is being spent. Figure 6-2 is a sample spreadsheet.

Each time money is spent, whether using a check, credit card, or cash, simply record the expenditure category it comes under. This is not unlike the types of accounting used in an optometric practice and for Internal Revenue Service (IRS) tax reporting.

TABLE 6-2

Estimated Costs for Attending an Optometry School in an Urban Area, 2008–2009

	Regular		Living at Home	
Budget Item	Annual	Monthly	Annual	Monthly
CLASS YEAR: FIRST YEAR (9 MONTHS)				
Tuition	$26,445	—	$26,445	—
SA fee	$105	—	$105	—
Lab fee	$572	—	$572	—
Equipment	$2,198	—	$2,198	—
Books	$1,200	—	$1,200	—
Direct costs	$30,520		*$30,520*	
Rent and utilities	$8,550	$950	—	—
Personal expenses	$4,050	$450	$2,250	$250
Transportation	$2,250	$250	$3,150	$350
Medical insurance	$999	$111	$999	$111
Living costs	$15,849	*$1,761*	*$6,399*	*$711*
TOTAL BUDGET	**$46,369**		**$36,919**	
CLASS YEAR: SECOND YEAR (9 MONTHS)				
Tuition	$26,445	—	$26,445	—
SA fee	$105	—	$105	—
Lab Fee	$428	—	$428	—
Equipment	$3,035	—	$3,035	—
Books	$451	—	$451	—
Direct costs	$30,464		*$30,464*	
Rent and utilities	$8,550	$950	—	—
Personal expenses	$4,050	$450	$2,250	$250
Transportation	$2,250	$250	$3,150	$350
Medical insurance	$999	$111	$999	$111
Living costs	*$15,849*	*$1,761*	*$6,399*	*$711*
TOTAL BUDGET	**$46,313**		**$36,863**	

Continued

TABLE 6-2

Estimated Costs for Attending an Optometry School in an Urban Area, 2008–2009– Cont'd

	Regular		Living at Home	
Budget Item	Annual	Monthly	Annual	Monthly
CLASS YEAR: THIRD YEAR (12 MONTHS)				
Tuition	$26,445	—	$26,445	—
SA fee	$105	—	$105	—
Lab fee	$581	—	$581	—
NBEO fee	$625	—	$625	—
Equipment	$450	—	$450	—
Books	$785	—	$785	—
Direct costs	*$28,991*		*$28,991*	
Rent and utilities	$11,400	$950	—	—
Personal expenses	$5,400	$450	$3,000	$250
Transportation	$3,000	$250	$4,200	$350
Medical insurance	$1,332	$111	$1,332	$111
Living costs	$21,132	*$1,761*	*$8,532*	*$711*
TOTAL BUDGET	**$50,123**		**$37,523**	
CLASS YEAR: FOURTH YEAR (12 MONTHS)				
Tuition	$26,445	—	$26,445	—
SA fee	$105	—	$105	—
Graduation Fee	$100	—	$100	—
NBEO fees	$1,250	—	$1,250	—
Direct costs	*$27,900*		*$27,900*	
Rent and utilities	$11,400	$950	—	—
Personal expenses	$6,600	$550	$6,600	$550
Transportation	$4,200	$350	$4,200	$350
Medical insurance	$1,332	$111	$1,332	$111
Living costs	*$23,532*	*$1,961*	*$12,132*	*$1,011*
TOTAL BUDGET	**$51,432**		**$40,032**	

Prepare a Budget

Use the general ledger data to complete a budget. A review of the general ledger will allow the development of a plan for future expenditures. This plan is called a budget. A budget refers to the cost or estimated cost of living or operating a business. A budget is a plan or schedule adjusting expenses during a certain period to the estimated or fixed income for that period. Businesses consider a budget a necessary tool for planning. Since the optometric student has invested in their career, the student can be considered a business. Use this tool to wisely plan expenditures.

Although the estimated student budget as established by the financial aid office may seem low by some standards, it is probably not unrealistic because it is based on the budget survey sent to all students. To work within the boundaries set by the standard budget, each student will have to make some very specific lifestyle choices. Completing the following planning and budgeting exercises will assist in making, as well as implementing, these choices.

Budgeting as a student is more difficult than as someone receiving a regular paycheck. Loans are given in lump sums or quarterly payments. Faced with a large amount of cash on hand, it may be difficult to keep in mind that a loan of several thousand dollars must cover expenses for 9 to 12 months. Prudent money management will ensure that the loan funds will not be spent within the first few months of receiving them. Two important strategies for dealing with quarterly or annual lump-sum payments are the following:

1. Deposit loan funds as soon as received, preferably in an interest-bearing account.
2. Investigate the possibility of investing these funds in an account or fund that pays a higher rate of interest than a regular checking or savings account such as a CD.

A CD is an agreement with a commercial bank that promises a fixed interest rate on funds deposited for a specified period of time. Typical time periods are 1 month, 3 months, 6 months, 1 year, and 5 years. Usually, the interest paid is higher for the longer terms. These accounts are guaranteed by the government for an individual up to $100,000. (A special provision provides for guarantees up to $250,000; however, unless extended by Congress this provision will expire December 31, 2009.) Note in Figure 6-3 that the 6-month CD rate is far less than the student loan rate of 6.8%. It is crucial to plan your budget before making hasty borrowing decisions that result in unnecessary debt.

Line no.	Company	Income	Food	Clothing	Rent/ mortgage	Utilities	Phone	Household expenses	Auto	Education	Entertainment	Personal	Gifts	Misc
1														
2														
3														
4														
5														
6														
7														
8														
9														
10														
11														
12														
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27														
28														
29														
30														
Total														

FIGURE 6-2 Sample spreadsheet.

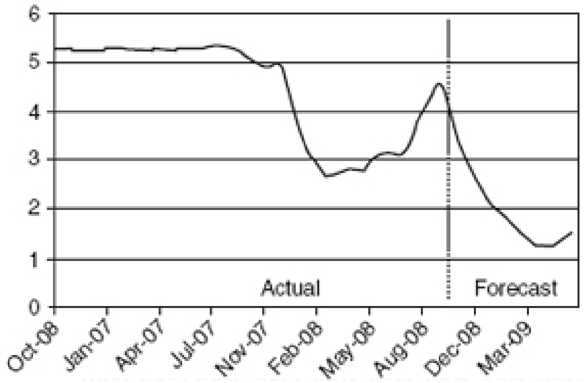

FIGURE 6-3 Six-month certificate of deposit (CD) interest rate. Past trend, present value, and future projection.

Mechanics of a Budget

To develop a budget, start by doing the following:

1. List all *steady* sources of monthly income.
   Financial aid
   Salary (after deductions)
   Spouse's salary (after deductions)
   Investment income
   Government checks
   Gifts
   Alimony/child support
   Other

From this list, calculate your Total Monthly Income.

2. List all *fixed expenses*. Fixed expenses are monthly or yearly expenses that are unavoidable because they have already been committed. They are usually unchanging in their amounts. There is no clear-cut distinction between fixed and variable expenses. It is up to the individual. An individual may or may not have all of the following expenses:
   Regular savings
   Rent/mortgage payments
   Utilities (gas, electricity, and water)
   Telephone
   Taxes (federal, state, and local)
   Vehicle payments
   Charge card payments
   Personal loans
   Education loans
   Life insurance
   Health insurance
   Home/renter insurance
   Automobile insurance
   Automobile registration/taxes
   Professional fees/dues
   Accountant services
   Tuition and fees
   Books and supplies
   Child care
   Other

From this list, calculate your Total Fixed Expenses.

3. List all of the variable, or day-to-day, expenses. Variable expenses are those that occur in different amounts and may not occur with regularity. An easy method for estimating variable expense is to keep track of every penny spent for the next 2 weeks. By doing this, spending priorities will be revealed and funds can be allocated accordingly. It is surprising how quickly small incidental expenses can add up.

Groceries
Meals and snacks away from home
Household supplies
Clothes
Laundry/dry cleaning
Gas, oil, and automobile maintenance
Medical/dental/medicine
Hobbies/recreation/entertainment
Travel/vacations
Pets, supplies, food, veterinarian expenses
Sports
Records and books
Child care/baby sitting
Health and beauty aids
Haircuts
Cigarettes, tobacco, alcohol
Postage
Subscriptions
Cable TV
Gifts
Charity/contributions
Other

From this list, calculate your Total Variable Expenses. To calculate your Total Monthly Expenses, use the following equation:

Total Fixed Expenses + Total Variable Expenses = Total Monthly Expenses

4. Look over the variable expenses and consider where they can be realistically reduced. Note that a savings account is included under the fixed expenses column. Not only should one be saving for large, planned expenses, but also funds should be set aside every pay period for large, unanticipated expenses. Savings should not be considered an option if there is any left-over money (all too often there is none) but should be a planned expense and treated just like any other monthly bill. The general rule of thumb is to have savings equal to 6 months of expenses. As a student, it is not unusual to find that saving any money is simply impossible. Family members or close friends can assist the student in case of an unforeseen emergency expenditure. However, the student should be aware of this very important aspect of the budgeting process and practice it as soon as feasible and definitely when receiving a regular salary.
5. Calculate the remaining income for the month by subtracting the income in number 1 from the expenses in number 3 (after reducing them realistically). The remaining income should be a little above zero. If the amount is higher, reduce the amount of higher interest student loans until the final figure is near zero. To calculate your Total Monthly Income, use the following equation:

Total Monthly Income − Total Monthly Expenses = Total Remaining Monthly Income

6. Complete a Predicted Cash Flow Chart.
   A budget will assist in calculating *how much* money is needed to borrow; a cash flow projection will determine *when* to borrow it. Remember, unsubsidized loan interest accrues as soon as the money is borrowed. Borrowing money when it is not needed will result in paying more for education.

In finance, *cash flow* refers to the amounts of cash being received and spent by a business during a defined period of time, such as a month or quarter or year. Most of the time cash flows are being used to determine gaps in the liquid position of a company. *A cash flow statement* is a financial report that shows incoming and outgoing money during a particular period (often monthly or quarterly). The statement shows how changes in expense and income accounts affect cash flow. As an analytical tool the statement of cash flows is useful in determining the short-term viability of a company, particularly its ability to pay bills. People and groups interested in cash flow statements include potential lenders who want a clear picture of a company's ability to repay a loan. Cash flow statements are particularly important for start-up companies with limited liquid assets. These companies are vulnerable to devastating cash shortages, even when Accounts Receivable balances point to long-term financial health.

CASH FLOW ANALYSIS AND NEED CALCULATIONS

The best way to determine if projected resources will cover academic year expenses is to prepare a cash flow projection containing monthly expenses and resources. Utilizing the monthly budget, enter the income and expenses as they occur in the appropriate rows on the cash *flow projection* sheet in Figure 6-4. Compare income resources with the expenses projected available during the academic year (Box 6-1).

Total the income columns to compare with the expense columns. Subtract the sum from the first month's total expenses and enter this figure under "net." The result should be a net positive balance (i.e., more income than expenses). Add each month's net to the net from the prior month and enter this under "cash flow." Continue this process until the entire academic year is covered or a net negative balance (expenses exceed income) results. If a negative balance arises, determine how to increase the income that month to pay the bills. If a workable solution cannot be discovered to increase additional income sources for that month, a payment will have to be late and a catch-up payment will be needed in a later month. Continue to maintain the negative figure in the bottom "cash flow" row. A negative balance is reduced or increased by the following month's balance. Continue this process until the last month's cash flow calculation is reached. This analysis helps identify when more income is needed, or if excess monies are being taken out in loans. Ideally, there should never be a negative cash flow for any month.

Analyze the cash flow projections. Was there enough money for the month when it was needed? Was too much money borrowed? Remember, the more money borrowed, the more the education is going to cost because of the additional interest expense.

CASH FLOW PROJECTION FOR SCHOOL YEAR________ to_________

Income	**Aug.**	**Sept.**	**Oct.**	**Nov.**	**Dec.**	**Jan.**	**Feb.**	**March**	**April**	**May**	**June**	**July**
Parental support												
Student income												
Spousal income												
Savings												
Student loans												
WICHE/contract												
Institutional financial aid												
Other												
TOTAL												

Expenses	**Aug.**	**Sept.**	**Oct.**	**Nov.**	**Dec.**	**Jan.**	**Feb.**	**March**	**April**	**May**	**June**	**July**
Tuition/fees												
Books/supplies												
Utilities												
Food												
Transportation												
Health care												
Personal												
Other												
TOTAL												
NET (income-expenses)												
CASH FLOW												

FIGURE 6-4 Sample cash flow projection sheet.

BOX 6-1

Projecting Income

- Parental (family) support may come in a variety of forms ranging from one lump sum to monthly allowances. Often, parents or other family members provide assistance by covering such expenses as health or auto insurance.
- Student wages/income relates to both on- and off-campus earnings. Place earnings in the appropriate monthly column on the basis of when monies will be earned.
- Spouse wages/income: for married students, include monthly net wages.
- Savings include any liquid assets. List total assets in the first month of the academic year. Do not provide figures for any other month at this time.
- Guaranteed student loan: list the total proceeds received from the lender in the month(s) the check is expected.
- Western Interstate Commission for Higher Education (WICHE)/contracts: list the amount of assistance the contracted state provides.
- Institutional financial aid: review the award letter. Place the disbursement amounts of NDSL/HPSL in the month expected.
- Other resources is a catch-all for any other income or resources received.

Projecting Expenses

- Begin by listing at the top of each column the months scheduled to be in attendance at optometry school (e.g., first and second year students, August to May; third and fourth year students, May to May).
- Enter the exact amounts charged for tuition and fees in the appropriate months payment is to be made.
- Books and supplies: the campus store provides every student with a list of required/recommended textbooks, manuals, and instruments, with approximate charges.

Another method to estimate probable expenses is to talk with upperclassmen as to their own experience in this area. They may be able to help list these expenses in the month(s) purchases will be made.

- Enter monthly rent/mortgage charges. Do not forget to list deposits, escrow, and other charges.
- Include the obvious utilities: gas, electric, water, cable, etc. Utilities generally vary over the course of a year. To get a knowledgeable estimate of what may be paid, consult the landlord and/or past tenants as to their experience with prior charges. Information can also be obtained from the various utility companies.
- Last year’s budget survey contained food allowances that ranged from $50 per month to $200 per month for single students! Consider this area very carefully. Although it may be unrealistic to get the expenses down to $50 per month, it may not cost $200 per month. Incidentally, the average last year was $106 per month for single students.
- Transportation includes travel to and from school, vacations, and weekly trips to and from the places regularly visited. Also note car payments, insurance, maintenance, parking, etc.
- Health care includes the cost of student health insurance, as well as unreimbursed visits to the physician and dentist and the cost of prescriptions.
- Personal/other is a catch-all. Sit down and do some brainstorming and list laundry, clothing, debt repayment, entertaining, gifts, haircuts, health and beauty aids, postage, etc. Do not go overboard but try to develop a realistic estimate of monthly needs.
- Total each monthly. It may be preferred to make grand totals by both row and column. Now, look over the totals. Do they seem high, low, or accurate?

In the future, this same process will be used to complete a budget for a practice. The expense categories will be different, but the process will be the same.

MISTAKES IN FINANCIAL PLANNING DURING OPTOMETRY SCHOOL

Few students have the financial intelligence and experience to ideally plan their finances during optometry school. Knowledge of common mistakes can assist you in avoiding some of the pitfalls that commonly occur. These mistakes include; forgetting expense categories, borrowing too much, and borrowing more than needed and investing the excess into risky investments.

Forgetting Expense Categories

Sylvia Porter, a well-known financial advisor, maintains that there are three expense categories people usually forget when planning a budget. The following categories usually lead to the collapse of a financial plan if they not considered:

- NIBBLERS: little things taken for granted that eat away at your money (laundry, haircuts, snacks, and newspapers)
- BOUNCERS: expenses that occur once or twice a year and are easy to overlook (insurance premiums; federal, state, and local taxes; and personal property taxes)
- SLUGGERS: emergency unplanned expenses that are disastrous if you have no savings to fall back on (medical expenses, appliance replacement, or car repairs).

Borrowing Too Much

The cost of education can be much higher if interest is paid on money you did not need to borrow. Suppose you borrowed $120,000 at 6.8% when all you really needed was $100,000. Over the course of the repayment period, typically 10 years, the amount paid would be $165,716 for the same education that should have cost $138,096. Also, it is estimated that there will need to be an annual salary of at least $165,716 vs. $138,096 to be able to afford to repay this loan assuming that 10% of gross monthly income will be devoted to repaying student loans. This corresponds to a debt-to-income ratio of 0.7. If 15% of the gross monthly income is used to repay the loan, the annual salary of only $110,477 vs. $92,064 is needed to repay the loan, but some financial difficulty may be experienced. This corresponds to a debt-to-income ratio of 1:1.

The timing of the amounts borrowed can have a significant effect on education as well. If the first year the borrowed amount was $40,500, $40,500 the second year, $24,000 the third year, and $15,000 the fourth year, more interest would be paid than if borrowed in reverse (i.e., more at the end than the beginning). Remember, interest accrues as soon as the money is borrowed on the unsubsidized Stafford loans. The money borrowed the first year costs more than the money borrowed the last year.

Borrowing Private Student Loans Disguised as Federal Loans

Private student loans are the fastest growing segment of the student loan market. They have no relation to the federal loan program except in many cases they are offered by the same forprofit companies that provide federally funded student loans. Whereas federally guaranteed loans have fixed interest rates, currently either 6% or 6.8%, private loans are more like credit card debt. Interest rates for these loans are not fixed and often run 15% or more, not counting fees. Most students have little experience in taking out loans, yet the federal government does not require lenders to disclose the total cost of a student loan and other terms upfront, as it does for car loans and mortgages.

According to the *Los Angeles Times* article "Hooked on Debt—Students Learn Too Late the Cost of Private Loans," these lenders include Sallie Mae, Bank of America, Citibank, myrichuncle.com, and JPMorgan Chase. These companies have been accused of using deception and discriminatory practices that left students saddled with the highest cost loans. A key strategy was to make students believe the loan officers worked directly for the college.

Loan shopping Websites also lure young people into private loans. One site, TuitionBids.com, encourages students to seek federal loans first but also had a "let the bidding begin" button that directed users to an application for a private loan. TuitionBids.com receives a loan fee when a customer secures a private loan. They make nothing when consumers get a federally guaranteed loan.

Using Student Loans to Invest in Stocks and Bonds

Some entrepreneurial students see student loans as a way of getting low-interest money to use in investing while in optometry school. If the optometry student or spouse already has a business of some type and requires additional capital that will result in increased income, this could be a good strategy. If, on the other hand, the money is wanted to give to a friend to invest in the stock market for the students benefit, it is advised to reconsider this option. History is ripe with unfulfilled promises from individuals about huge returns on investment of money. It may be best to avoid such a strategy and just borrow what is needed. Borrowing too much could result in future failures to repay the loan on time and affect your credit rating. In the future, your borrowing power will depend on a good credit rating. While in optometry school, take steps to establish and improve the credit rating number.

Incurring High Credit Card Debt

Responding to rising consumer complaints, federal regulators adopted new rules for the credit card industry that take effect in July 2010. The new regulations would block credit card companies from applying higher interest rates on existing balances. Late fees could not be charged without giving consumers at least 21 days to make a payment. Federal Reserve Chairman, Ben S. Bernanke, said the new measures were needed to reverse a trend in which the pricing schemes and terms of credit cards have grown increasingly complicated and obscure, leaving consumers frustrated by mysterious charges. These credit card policies have resulted in many of us incurring high credit card debt, which is difficult to pay off.

GETTING OUT OF DEBT

If you routinely spend more than you earn, are forced to make day-to-day purchases on credit or are able to make only the minimum payments on monthly credit card debt you are over your head in debt. Relieving your financial stress is often possible by implementing some common sense measures (Box 6-2). However, sometimes credit counseling can be helpful. There are legitimate nonprofit credit counselors that work free of charge or for modest fees, but according to the Federal Trade Commission (FTC), many credit counseling companies charge more than their advice or services are worth. Check the FTC online tips at www.ftc.gov/bcp. Click on "Credit Counseling". The National Foundation for Credit Counseling (NFCC) guidelines can be found at www.debtadvice.org. Click on "Credit Counseling" and then on "Guidelines for selecting the right counseling agency".

DEVELOP A GOOD CREDIT RATING

When it comes time to borrow money to begin practice or buy a house, the lending institution will run a credit check to evaluate the borrowers spending habits. They know that if a $5,000 balance on a credit card was not paid off in a timely manner, then this individual will be a poor risk to loan $150,000. They want to know if the borrower bought too many "things."

When purchasing something on credit, a record of the transaction is routinely submitted to at least one of the three national credit-reporting agencies. These agencies maintain records on millions of borrowers and their credit transactions. When you attempt to borrow money, the lender will obtain your credit report to determine whether that individual can qualify for a loan and the interest rate at which that person can borrow. The three national credit agencies are Equifax, Experian, and TransUnion. You can obtain a copy of your credit report for free at www.annualcreditreport.com .

Financial institutions contact these credit agencies to find out a person's "credit score"; this credit score is used to determine

BOX 6-2

Guideline for Getting Out of Debt

Short Term – Obviously eliminating climbing debt requires making more money or reducing expenses. Since the first would already have been done if possible, the most immediate steps involve cutting current expenses.

- Eliminate unnecessary spending such as entertainment and impulse spending. Purchase only those things that you must have – food, medicine, rent. Stop using credit cards! Spend only the cash you have. You must stop increasing your debt.
- Consolidate debt (credit cards, personal loans, automobile loan) through a short term bank loan, if possible, or mortgage refinancing which has the advantage of lowering the interest rates being paid.
- Decide on a strategy. Decide on whether you wish to pay the highest interest rate debt first (best financial decision), pay off the largest debtor first or pay off the smallest debts first. The later has the advantage of retiring multiple small debts which gives you the more immediate satisfaction of making some progress. Once you have decided on a strategy that you feel works best for you, stick with it!

Medium Term

- Start paying more than the minimum required payments. Otherwise you will spend far too much in interest and take far too long to retire your debts.
- Repair your credit by dealing with creditors rather than avoiding them. Contact them to work out payment options that will preclude them issuing adverse credit reports. You are allowed a free credit report annually. Go to AnnualCreditReport.com.
- Pay off credit card debt and close all unused credit card accounts. A credit report that shows you have voluntarily closed accounts signifies that you are actively managing your credit lines.
- Stay with your plan – you did not get into debt in a week and you won't get out of debt in a week.

Long Term

- Learn from your present situation and avoid making similar mistakes in the future. Stay out of financial trouble. The most important tool for doing so is to use the methodology described in this chapter to create and follow a monthly budget.
- Regular payments on credit cards create a strong credit history. Once able use your credit cards but insure you pay the end-of-month bill in full avoiding unnecessary interest charges. It may take a couple years to restore a good credit rating but your history of incurring small debts and repaying in full month after month will eventually restore your credit rating.
- If you want to purchase something save for it. Only use financing for items that are absolute necessities – home or car.
- Establish an emergency fund.
- Consider what opportunities might exist to increase earnings. Do you have skills or hobbies from which you could earn income?
- Pay yourself first. Create a budget that allows you to consistently put money aside for the future. This is imperative! (See Chapters 37 and 38.)

how much of a risk the institution will take if they loan money to this person. The higher the score, the less risk, and the lower the interest rate that person will be required to pay. Credit scores are often called FICO (Fair Isaac Corporation) scores. They compare each person to millions of others with a credit history. These credit scores can be purchased from each of the three agencies by going to www.myfico.com.

The credit report includes all open credit accounts and closed accounts, bank cards, car loans, mortgages, college loans, the date accounts opened, credit limits, loan amounts, current account balances, and payment history. It also includes a listing of everyone who has accessed the credit report in the last 2 years, voluntary requests (when you applied for credit), and involuntary requests (preapproved credit offers). This report can even include your gas or electric bills.

Credit scores incorporate the following 5 weighted factors:

Payment history	35%
Amounts owed	30%
Length of credit history	15%
New credit	10%
Types of credit used	10%

Credit scores range from 300 to 850; the median FICO score is 723. Mortgage lenders look for scores of at least 720, but 660 is a common baseline for smaller consumer loans.

ESTABLISHING CREDIT

What can one do to build up a credit rating, yet not go broke? Start by opening checking and saving accounts. Better to connect the savings account directly to the checking account. Your bank can be local or online. Consider requesting both debit and credit cards.

Build a good credit history by paying your bills on time. Do not apply for credit you do not need. Keep balances relatively low on revolving accounts. Check your credit report on a regular basis. Seek out credit cards without an annual fee. Restrict yourself to one or two cards to mainly use for special situations such as renting a car. Choose credit cards with low annual interest charges. Interest rates on credit cards can range from 10.92% to 24%! Make sure your card does not charge interest from the date of transaction. Some credit cards do and people pay interest even if payment is sent as soon as the statement is received. It is not surprising that people get in trouble trying to pay off a credit card balance at an interest rate of 24%. The interest alone makes it difficult to pay off. Sites for comparing different credit cards are www.creditcards.com, www.creditcardguide.com, and www.bankrate.com.

How much credit can a person handle? To be safe, the monthly consumer credit payments (excluding mortgage payment) should not exceed 20% of your take-home pay. How much is the take-home pay as a student? Do not spend money you do not have. Never pay interest on credit card purchases unless absolutely necessary (i.e., an emergency).

REPAIRING CREDIT

If faced with excessive credit card debt on multiple credit cards, it is advisable to come up with a plan to handle these debts. The first step is to call the credit card companies and try to have the interest rate lowered. It is worth a try and if there is a good credit history and FICO score, an adjustment could be made. Consider looking for credit cards that offer a lower interest rate. Transfer the balances from the high interest rate cards to the lower interest rate cards. Make sure that there are no penalties or hidden fees associated with this transfer. Once all the negotiations and transfers are done, a payment plan to correct the situation needs to be created.

A technique to pay down the balances is as follows:

1. Determine the interest rate paid on balances for each credit card available (both cards with outstanding balances and those without balances).
2. Make a list of the cards, with the highest interest rate card at the top of the list and the rest of the cards in descending interest rate order (not highest balance).
3. Next to the interest rate of each card, enter the minimum payment due for each card.
4. The object of the list is to identify the cards with the highest interest rate and concentrate on paying these cards off first, working down the list as the balances are cleared.
5. The payment system requires that the first card on the list with any outstanding balance should be paid off first. Make minimum payments on all other credit cards and large payments (as much over the minimum payment as possible) on this first card. This payment schedule is to be continued until this first card is paid off. Then move on to the next card on the list. The extra money paid to the first card is now paid to the next card until it is paid off. Continue this process for all credit cards on the list.
6. It is important to pay on time for all cards.
7. High interest rate credit cards that are paid off should not be used or should be shredded. It may not be a good idea to cancel these cards since this may have a negative impact on your FICO score.
8. Once the credit card debit is cleared, it is advisable to use only the lowest interest rate card if needed or primarily use only a debit card. If a credit card is used, it is important to pay off balances and pay on time.

MANAGING DEBT AFTER GRADUATION FROM OPTOMETRY SCHOOL

After 4 years of being a “starving student” in optometry school, most of us will want to live an improved lifestyle. This often means spending new hard-earned money on products and services that do not improve your net worth. Books like *The Millionaire Next Door and Rich Dad Poor Dad* explain that to increase wealth from humble beginnings, the individual has to rein in expenses and invest in accruing assets that result in increased income. By continuing to reinvest income into more and more income-producing assets, a new graduate can increase his or her net worth and expand the possibilities that life has to offer.

Student Loan Repayment

One of the first things to consider when coming out of optometry school is the effect of student loans on debt management. The interest rate on student loans is commonly a variable rate and changes with the going rate of Treasury bills and other factors. There is an option, as the optometric student approaches graduation, to consider loan consolidation. This action could eliminate the variable rate shifts. Loan consolidation is designed to make repayment of loans more convenient and may impact the size of the monthly payments or interest charges. The consolidation loan combines the outstanding amounts of principle and accrued interest of all loans included in the consolidation and pays off the original loans in full. The new interest rate can be locked-in to a certain rate for the entirety of the repayment. It is important to remember that the consolidation may increase the total cost of borrowing the money if the term of the loan is extended.

If the original loans are from a private lender, there may not be a consolidation option. If not, ask about different repayment options. Be sure to ask the monthly cost, term of the repayment, total interest charges, and if the interest rate is fixed or variable, the range of variation and the frequency of the change.

Loan consolidation can also offer an opportunity to choose a payment plan that fits better into your financial plans. The repayment term is from 10 to 35 years, depending on the plan you choose. If the goal is to pay off the debt as quickly as possible, then choose a term that is shorter (10 years) but make sure your monthly payment is affordable. Remember that the shorter the term, the less interest will be paid on the money borrowed. If paying the loan down in the extended terms (up to 35 years), remember that there is no prepayment fee if the payments can be accelerated and the loan is paid off ahead of schedule. If considering consolidation, consult with more than one lender to determine the real cost and advantages as compared to maintaining separate loans. Ask the following questions to help sort out your best options:

1. How will consolidation affect the grace period and/or deferment options?
2. How will the interest rate on the consolidation loan compare with the interest rates of the separate loans?
3. What will happen to the interest rate caps? How does this compare to the interest rate caps on the original loans?
4. What fees (hidden or up-front) will be paid to consolidate the loans? On consolidation, accrued and unpaid interest is capitalized (added to the principal balance) and interest is paid on the interest.
5. Are there repayment options available under consolidation that are not offered in the original loans?

There is a window of opportunity to take advantage of this type of program from the date of graduation until about 6 months after graduation when the loan repayments begin. In many instances, the interest rate that can be locked-in is lower than the interest rate of the various loans. This could save a significant amount of money over the term of the repayment and assure that the payment amount is always a constant and more easily planned for.

If consolidation is considered, the terms need to be understood. The due diligence regarding loan consolidation will determine the path that is best for individual situations. Once the consolidation is completed, there is usually no longer any eligibility for deferment of the loans. Repayment is scheduled until the balance has been paid in full. Be sure to have your lender carefully explain the pros and cons of this step. Most school loans are eligible for consolidation. Below is a list of the loans that can be consolidated: Federal Stafford loans

Federal Plus (parent) loans
Federal Family Education Loan Program (FFELP)
Federal Perkins Loan Program or National Direct Student Loans (NDSL)
Federal Insured Student Loans (FISL)
Federal Supplemental Loans for Students (SLS)
Loans for Disadvantaged Students (LDS)
Health Education Assistance Loans (HEAL)

If all the student loans are from the same lender, consolidation must be done with that one lender. If the loans are from a variety of lenders, consolidation can be done through banks, credit unions, and other loan sources. Information can be obtained from the Department of Education (loan consolidation program). Call 800–557–7392 or go to their Website at http://loanconsolidation.ed.gov. With this consideration understood and factored into the debt picture, the process of generating wealth should be your main goal.

To generate wealth, it is best to invest money into incomeproducing products rather than products that increase expenses. For example, although a new home may seem to be a product of value, it increases expenses in utilities, upkeep, homeowners insurance, and mortgage interest expense. Robert Kiyosaki, the author of *Rich Dad Poor Dad*, recommends investing in property and renting it out while initially living in a modest dwelling and paying rent. An alternative would be to purchase a home, and then rent out rooms to generate income. However, if you are reasonably sure you will not be moving for several years, compare the costs of home ownership with those of renting. You may be surprised that ownership is the best alternative considering the fact that you are increasing equity as you pay off principle borrowed, and if you purchase wisely and in a good area, you may also benefit from appreciation of your investment over time.

Purchasing a new car results in added expenses of car payments, car insurance, gas, state registration fees, and upkeep. Unless you are renting out the vehicle to others, a car can diminish your net worth. Borrowing money, increasing debt to buy a house to live in, or a new car will slow down the march toward generating wealth, unless new home costs are less than rent and a new car costs less than the old with high maintenance costs.

Debt Ratio for Buying a House

Debt will prevent additional borrowing of money to invest in a home or optometric practice. The bank wants to be sure the borrower can afford to pay them back before they provide a loan. One way lenders consider one's ability to repay is by making sure the total debt payments do not exceed a certain percentage of income, usually 36% to 42%. This percentage is called the debt ratio. Debt ratio is equal to monthly debt (credit cards, auto loans, and school loans) divided by monthly income before taxes.

For example, a borrower makes $9,000 a month and has no debt. The bank would figure that this person was not overextended as long as mortgage payments, including taxes and insurance, would not exceed $3,240 (36%) to $3,780 (42%). In another example, there is some debt, perhaps a student loan, some credit card debt, and a car payment. The borrower has $9,000 in monthly income and $2,000 in monthly debt. Remember, the bank wants the borrower to have no more than about 38% of income as debt. So, with $9,000 a month in income, $3,420 a month is available for total debt. ($9,000 × 38%). Out of that $3,420 a month, there is already $2,000 a month in debt, which leaves only $1,420 a month for mortgage payments.

One of the situations many young graduates get into is they go to work as an employee, buy a car or a house, which results in a debt ratio that causes them to be unable to borrow money later to begin their own practice or buy into a practice. They become trapped in an employment situation that becomes stagnant and not what they had dreamed about when considering a career in optometry.

A smarter strategy may be to purchase a practice, buy into a practice, or borrow to begin a new practice before incurring debt through car, house, or credit card loans. The practice will be an income-producing asset that can generate wealth rather than drain wealth through added expenses.

FOUR WAYS TO PRODUCE INCOME

Investing money in a business, such as an optometric practice, can increase net worth and allow the generation of wealth. The book, *Cash Flow Quadrant*, explains that the ways to make income is one of four ways: as an employee where an individual works for someone, self-employed where an individual owns a business, businessman where an individual owns systems and others do the work, or as an investor where an individual uses their money to generate income in securities. A *security* is a fungible negotiable instrument representing financial value. Securities are broadly categorized into debt securities (such as bank notes, bonds, and debentures), and equity securities (such as common stocks, mutual funds, bonds issued by corporations or governmental agencies, stock options or other options, limited partnership units, and various other formal investment instruments that are negotiable and fungible).

If one chooses to be an employee, one will need to learn how to invest saved money into other businesses or securities to generate wealth. Since an optometrist's expertise is in eye care, it would make sense to invest there.

Being self-employed and owning a solo, partnership, or group practice means the optometrist should invest back into the practice until such a time that the business has maximized its possible return. At that point, it must be decided whether to become a businessperson and hire other doctors into the practice, branch out, or take the profits and invest them into another business or security.

As a businessperson, one must develop systems that give the option of doing the work oneself or having others do the work. An example of this would be to own an office or partnership and hire other doctors and staff to see patients. The advantage of producing income this way is the office can continue to grow and reinvest into the business, even if the owner rarely sees patients himself or herself.

Making income as an investor can require an entirely different set of skills than that of your optometric training. The recent recession is a good example of the pitfalls that can occur beyond the control of even knowledgeable investors. Many doctors give their money to professional brokers to invest it for them. Recall that optometrists are experts in eye care. Only invest in areas outside of eye care if you have an expertise in these areas or have someone you trust explicitly.

HOW MUCH MONEY IS NEEDED TO LIVE THE LIFE DESIRED?

Go back over the personal and professional goals covered in Chapter 2 and put a monetary value on the cost of reaching these goals. This will provide an idea of the sacrifices required after graduation to generate the wealth necessary to reach your goals. Typically, this means that a new graduate must remain a “starving student” for a few more years after graduation until able to invest in income-generating assets that will allow the accumulation of the wealth necessary to reach goals.

If an optometrist has been an employee for a number of years after graduation and now wants to start or purchase into a practice, then the return to a “starving student” lifestyle may be necessary to qualify for the loans needed, as well as the budget for the monies needed to repay the loans. The financial planning for this scenario is demanding, and lack of planning can make the dream of practice ownership unattainable by optometrists who are caught in the financial rat race.

A good goal for anyone, especially as one nears retirement, is to generate passive income exceeding their expenses. The IRS defines passive income as “any activity… in which the taxpayer does not materially participate.” Examples of this are as follows:

- Residual income: repeated regular income, earned by a salesperson, generated from the payment of a product or service that must be renewed on a regular basis, to continue receiving its benefits
- Rent from property
- Royalties from publishing a book or from licensing a patent or other form of intellectual property
- Earnings from Internet advertisement on Websites
- Earningsfromabusinessthatdoesnotrequiredirectinvolvement from the owner or merchant (i.e., a laundromat).
- Dividend and interest income from owning securities, such as stocks and bonds, is usually referred to as portfolio income, which can be considered a form of passive income.
- Pensions

Once passive income exceeds monthly expenses, you do not have to work at all, which is the main point Robert Kiyosaki makes in his book *Rich Dad Poor Dad*. For Kiyosaki, borrowing money means generating debt that can be paid off with the income produced by the investment.

MANAGING DEBT WHILE OWNING A PRACTICE

Chapter 8 provides information to properly analyze a practice and determine whether borrowing money will be prudent or not. The thought patterns will be quite similar to those decisions made while in school and when graduating. Managing debt during retirement will be covered in Chapter 40.

Each of us has different goals requiring different amounts of money to reach them. We all have a tolerance for different risk levels and situations. Use the basic premises discussed in this chapter to manage debt and you will be able to make logical decisions on how you spend money during each phase in your optometric career.

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