Law Degree Economics:

How Federal Legislation has Improved the Economic Value of a Law Degree

Presented by:
Jason DiLorenzo
Boalt Hall
Spring 2012
Overview

• Brief Examination of Law Career Economics

• Income-Based Repayment (IBR): What it is and how graduates can navigate it to keep liquidity early in career and be positioned to maximize potential forgiveness

• Strategic debt reduction and other financial objectives (home purchase, stock market)

• Boalt Hall Graduate Profile:
  - Average indebtedness of 2010 grads with law school debt: $104,198
  - Percent who work in Public Interest: 18 – 20%
Changes in Student Debt Levels

Debt levels have doubled in the last 7 years

* Based on data collected by The American Bar Association and GL internal student database
Law Class of 2009 Salaries

% Salaries

Above Mean Mode

Below Mean Mode

Mean $85,198

* Source: Wall Street Journal
MBA Class of 2009 Salaries

% of salaries

MEAN PAY: $87,600

Data: PayScale, select school data

MBA Salary Distribution More Normalized
Career Paths

1. Large Firm  -- Corporate, Product Liability, Bankruptcy, etc.

2. Small Firm   -- Small Law Firm, Solo Practice, In-House Counsel, etc.

3. Non-Profit   -- Non-Profit or Government Entity
Career Paths

Salaries and Debt Levels

Large Firm: $115k Salary, $109k Student Debt
Small Firm: $65k Salary, $109k Student Debt
Non-Profit: $45k Salary, $109k Student Debt
**Impact of Legislation**

**Salaries and Debt Levels**

<table>
<thead>
<tr>
<th>Years</th>
<th>Monthly Payment</th>
<th>Poverty Line</th>
<th>AGI Deduction</th>
<th>Income Multiplier</th>
<th>Debt Outstanding</th>
<th>Wage</th>
<th>AGI</th>
<th>Marginal Effective Tax Rate</th>
<th>Effective Tax Rate</th>
<th>Disposable Income</th>
<th>Available Savings</th>
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<tr>
<td>1</td>
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<td>$21,855</td>
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<td>$116,730.00</td>
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<td>$65,000</td>
<td>22%</td>
<td>21%</td>
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<td>$59,698.04</td>
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**Discount Value for Today**

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<th>Year 1</th>
<th>Discount Value for Today:</th>
<th>0.909090909</th>
<th>0.826446281</th>
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<td>$1.164.97</td>
<td>$1.655.49</td>
<td>$2.199.50</td>
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**Savings w/Int & Residual**

<table>
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<tr>
<th>Large Firm</th>
<th>Small Firm</th>
<th>Non-Profit</th>
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<tbody>
<tr>
<td>Sum of Disposable Income:</td>
<td>$532,177</td>
<td>$29,715</td>
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<tr>
<td>Sum of Residual Loan Cost:</td>
<td>$27,895.83</td>
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<tr>
<td>Savings w/Interest:</td>
<td>$62,359.37</td>
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<tr>
<td>Savings w/Int &amp; Residual:</td>
<td>$532,177</td>
<td>$29,715</td>
</tr>
</tbody>
</table>

**Modeled Increase In Available Savings Due To Legislation**

- Large Firm: $532,177
- Small Firm: $29,715
- Non-Profit: $62,359.37
Career Paths

Salary Equivalent For Increase In Personal Earnings

- Large Firm: $115k
- Small Firm: $65k (Salary) $81k (Salary (Equ.))
- Non-Profit: $45k (Salary) $72k (Salary (Equ.))

New Programs Increase After-Tax Savings
Regulatory Changes

• 1965: Higher Education Act enacted
• 1986: Subsidized and Consolidation Loans created
• 1992: Stafford Loan limits increased
• 2006: Grad PLUS made available
• 2007: Public Service Loan Forgiveness enacted
• 2009: (July 1st): Income-Based Repayment (IBR) effective
• 2010: IBR Enhancements (2014)
• 2011: ** Budget Control Act **
• 2011: Pay As You Earn (PAYE)

Public Service Loan Forgiveness and IBR provide greater cost savings than all other amendments
**Income-Based Repayment**

**Partial Financial Hardship**

- Limit monthly payment to 15% of discretionary income, capped at 10-year standard payment

- 2014 and PAYE: Monthly payment limit reduced to 10%

**Government Subsidy**

- Subsidized interest not covered by reduced payment is paid by government

- Subsidy is provided for maximum of 3 years

**Loan Forgiveness**

- After 25 years any outstanding balance is forgiven

- 2014 and PAYE: Forgiveness after 20 years
Income-Based Repayment

• **Goal for Law borrowers:**
  1. Minimize Payment Burden Early in Career for Liquidity
  2. Maximize Any Available Subsidy and Forgiveness

• Problem is IBR process and forms are complicated and unintuitive, furthermore lenders and government have disincentive to support.

• **Common mistakes made by borrowers with IBR:**
  • Using salary data instead of AGI
  • Provide supporting documentation not reflective of actual AGI
  • Not using the most appropriate tax data and filing year (married joint/separate, etc.)
  • Timing of filing
How is IBR calculated?

\[
\frac{(AGI - 150\% \text{ Poverty Level}) \times 15\%}{12 \text{ months}}
\]

Estimate in years 1 & 2 for graduate with $120k Salary:

\[
\frac{($60,000 - $16,335) \times 15\%}{12 \text{ months}} = $546 / \text{mo.}
\]
IBR Payment and Subsidy: Small Firm

Limits monthly payment to 15% of discretionary income

Assumptions: Based on last year’s AGI, except first year based on current AGI. AGI is $3,000 less than salary. Starting salary is $65,000 which is pro-rated for first year. Salary increases 3% after 2nd year; Poverty line for single person increases by 3% after 2nd year; Family size increases to 2 in the third year and 3 in the fifth year. Loan Portfolio: $25,500 of $120,000 debt is subsidized.
New Program Details

Income Based Repayment:
  • Limits monthly payment to 15% of discretionary income

Loan Forgiveness:
  • Outstanding debt forgiven after 10 years for public service
  • Outstanding debt forgiven after 25 years for private sector
IBR Loan Forgiveness: Small Firm

Loan Repayment

Total Debt Payments of $262,214
Total Debt Payments of $177,741

Monthly Payment

$1,500
$1,000
$500

1st 5th 10th 15th 20th 25th

Repayment Years

$874

25 Yr Term

= IBR

Total Debt Burden Reduced By More Than 32%

Total Debt Payments of $262,214
Total Debt Payments of $177,741

All Debt Forgiven $158,850 (taxable)

$860

= 25 Yr Term

$874

$500

1st 5th 10th 15th 20th 25th

Repayment Years

$1,000

$1,500

Total Debt Burden Reduced By More Than 32%
Public Service Loan Forgiveness

Federal program enacted by Congress in 2007

Many medical residents are not aware of the applicability and immense value

Specific requirements:

• Borrower must make 120 qualifying payments on a Federal Direct Loan
• Borrower must work for a public service entity as defined by the program, such as a Federal, State, Local, or non-profit organization
• New Employment Certification Form (released 2012)
Loan Forgiveness: Non-Profit Career

- Total Debt Payments of $169,782
- Total Debt Payments of $21,619

- Monthly Payment: $1,414
- Monthly Payment: $222

- $1,500
- $1,000
- $500

- 1st
- 5th
- 10th

- All Debt Forgiven $181,626

Total Debt Burden Reduced By More Than 87%

Same assumptions as previous slides except this scenario assumes a $45,000 salary.
Structuring Your Repayment (No Forgiveness)

Typical Repayment Plan

- Consolidation – 4.75%
- Stafford – 6.8%
- Grad Plus – 7.9%
- Private Loan - 9.25%

Effective Rate (APR) = 6.29%

Targeted Repayment Plan

- Non-payment 4.75%
- Non-payment 6.8%
- Non-payment 7.9%
- 9.25%

Effective Rate (APR) = 5.69%

*Assumes $168,000 in federal debt and $8,000 in private loans
What We Will Cover:

• New landmark legislation and impact on law professionals
• Action Plan based on individual’s situation
1. Review LRAP benefits if pursuing public service, meet with LRAP advisor (required)
2. Tax Preparation
3. Ongoing Loan Review

1. Structure Consolidation
2. Tax Preparation
3. Repayment Management:
   a) PSLF
   b) IBR/PAYE
   c) Targeted Repayment
4. Liquidity Planning
Other Objectives and Tactics
Federal Loan Consolidation

• Traditional Consolidation
  + Transfer to Direct Loans for PSLF Eligibility (Berkeley is a DL school)
  + Option for a 30 year term (lower payment)
  + Administrative Simplicity

• Special Consolidation (June 30th 2012 deadline)
  – Transfer to Direct Loans for PSLF Eligibility
  – Not a traditional consolidation
  – Transfers each loan individually
  – Only applicable to FFELP loans*
  – Interest Rate Benefits but no 30 year term

*Borrower must have a Direct Loan in portfolio

Source: studentaid.ed.gov/specialconsolidation
Measuring Financial Progress

- Assets
- Liabilities
- Net Worth
Proper Allocation

Allocation of Your Money

- Investment
- Savings
- Paying Down Debt

Appropriate Measurement Leads to Proper Allocation
Stock Investing

Pre-Tax Returns
PLUS Loan
S&P 500

8.1% Average PLUS Return
7.4% Average S&P Return (A/T)

Sources: Yale Econ/Robert Shiller, Standard & Poor’s, Federal Reserve, Bloomberg

All Returns Here Are After Tax
Home Or Practice Purchase

• New Attorneys lack liquidity in early years:
  • Most make major purchase (home, practice, etc.)

• Even if loans can be secured with minimum liquidity
  • The incremental cost has increased substantially
$750,000 Home Purchase

Down Payment

<table>
<thead>
<tr>
<th>0%</th>
<th>10%</th>
<th>20%</th>
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</thead>
<tbody>
<tr>
<td>$0</td>
<td>$75,000</td>
<td>$150,000</td>
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</tbody>
</table>
Home Or Practice Purchase

Pre-Credit Crisis

- Zero Down Premium
  - Rate with 10% Down (5.0%)

Today

- Annual Interest Cost
  - $8,943
  - $75,000
  - $9,787
  - $875

$100,000

17% Annual Cost On Down Payment
Liquidity Solution

Increase In Liquidity of ~$60k

Monthly Payment
$2,000
$1,000

1st 5th 10th 15th 20th

Repayments Years

$1,577
$1,000
$2,000

Increase In Liquidity of ~$60k
Tax Considerations

Taxes during school and after the Bar Exam:

• Hope and Lifetime Learning Tax Credit OR Tuition and Fees Deduction
• Annual Review: Married Filing Jointly vs. Married Filing Separately
• State Community Property laws

Many Law Students Not Taking Advantage Of New Tax Breaks
1. **Income-Based Repayment & Loan Forgiveness Programs**
   a) Benefit all law school borrowers and highly advantageous for most
   b) Process begins during school for all borrowers

2. **Consolidation to Maximize Savings**
   a) Initial consolidation review should be completed
   b) File taxes in final year as appropriate

3. **Tax Implications**
   a) All borrowers should file taxes regardless of income status
   b) Tuition and fees deduction often superior to Lifetime Learning Credit due to IBR
   c) Understand the trade-off of filing jointly with spouse

4. **Graduating Students**
   a) Utilize IBR and non-payment status to increase subsidies and liquidity
   b) Be leery investment advisors conflicts -- only invest when returns exceed cost of debt

**Summary**

New Programs Apply To All Law School Borrowers
If you have any questions or would like a free personalized debt assessment please contact:

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jdilorenzo@gladvisor.com
Main: 877.552.9907

Or visit www.glAdvisor.com

www.facebook.com/glAdvisor       www.twitter.com/glAdvisor

All government sponsored programs are subject to their continued existence, availability and participation requirements.

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Appendix
# IBR Charts

**Family Size = 1, Lower 48 States**

<table>
<thead>
<tr>
<th>Salary</th>
<th>$50,000</th>
<th>$75,000</th>
<th>$100,000</th>
<th>$125,000</th>
<th>$150,000</th>
<th>$175,000</th>
<th>$200,000</th>
<th>$225,000</th>
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<td>$1,800.16</td>
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- **Payment Capped (10 Year Std.)**
- **Payment < 10 Year Std.**
- **Payment < 25 Year Std.**

*Confidential Document, Property of Graduate Leverage, LLC, rev 033110*
## IBR Charts
### Family Size = 1, Lower 48 States

<table>
<thead>
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<th>Salary</th>
<th>Debt</th>
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### Payment Capped (10 Year Std.)

- Confidental Document, Property of Graduate Leverage, LLC, rev 033110
Benefits of Special Consolidation

$81,000 using 10 year Standard

Loans Remain Separate: Allows for Targeted Repayment