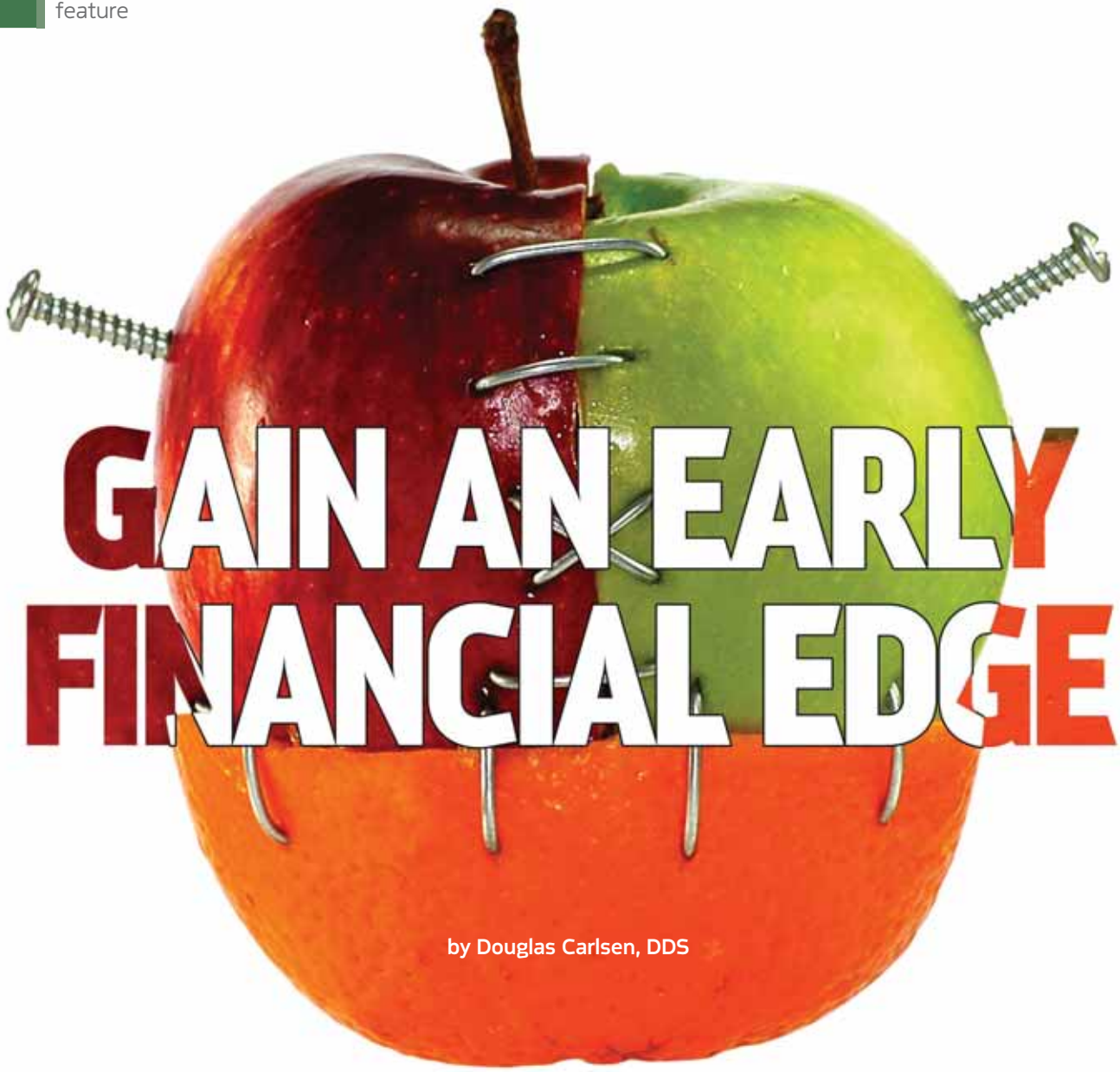

GAIN AN EARLY FINANCIAL EDGE

by Douglas Carlsen, DDS

"The plan is: Attack the smallest one first, wipe it out, and take what you were paying to go after the second smallest balance and repeat the process until done."

You are finally done – a doctor. And you've waited seemingly forever as your non-medical friends now have nice autos and purchased a home. They also have the time and money to dine out and entertain frequently.

But it's your time to shine! That first BMW and mortgage are way overdue. And these possessions need be at least as nice or nicer than your peers. You've earned it! Right?

Not so fast. You might be able to cut a prep with a 400,000rpm handpiece in a couple minutes, yet the full restoration takes time and patience to build longevity. The same is true of your financial strategy. Student loans now average more than $150,000 at public dental schools and well over $400,000 at some private dental schools. These loans present a formidable financial challenge and decisions made early in one's career have huge effects on financial stability in the future.

I stress tough financial principles, yet doctors that follow the principles in this article later generate significant wealth in their 50s.

Two Young Doctors

Let's follow two real dentists, both who learned hard financial lessons in the 2000s.

First Dr. C., who declined an actual interview, provided me valuable financial information:

Dr. C. graduated from USC Dental School in 2003. He married in 2003 and bought a 2,500-square-foot home in inland San Diego in 2005 for $700,000. The home was in a nice, yet not extravagant community. His monthly payments at 6.5 percent interest were $4,700, including mortgage insurance. 2005-2006 was the peak of the housing bubble in Southern California. His home is now worth $500,000, so any refinance is impossible.

He and his wife's student loans (she went to USC undergrad) totaled $400,000 upon graduation in 2003. He has a 25-year extended repayment plan loan at 4.5 percent (much lower than in 2013), paying $2,225 per month.

"The young dentist will buy into an insidious mental framework of debt being a natural part of life. It isn't. If you tie your identity to debt, you'll end up needing to work 10 to 15 more years than the dentist who doesn't."

Immediately upon marrying in 2003, Dr. C. and his wife leased a BMW Z4 and 530i, totaling $1,500 per month. Guess who got the Z4!

Dr. C. associated at a corporate dental clinic in Southern California for three years. Then in early 2006 bought a small practice in North San Diego County for $500,000. It was in an ideal location and had a seemingly bargain-basement price. His 10-year practice loan is $6,000 per month.

Before purchasing the practice, Dr. C.'s accountant cautioned that Dr. C.'s personal monthly debt payments would total nearly $15,000 including the cars. He indicated Dr. C. would need a net annual income of $400,000+ just to eat! Dr. C. ignored the accountant, as he was sure the practice would net much more than the broker's projection of $175,000.

Why wasn't Dr. C. worried? The real estate world was on fire in early 2006 and any financial headaches could be remedied via a refinance or home equity line of credit. That $700,000 home would certainly appreciate.

By early 2008 Dr. C. realized he had a problem. Not only did he net $150,000 in 2006 and 2007, but also he needed to sign up for numerous PPOs with reduced fees to keep his patient base. He was financially drowning.

He walked away from his home in 2009 – one of the early strategic defaulters – and still drives the 2006 BMWs he purchased upon lease expirations in 2009.

Dr. C. and his wife now live in a trailer down by the river, dine out at Taco Bell, yet still can shop at Nordstrom Rack. Just kidding about the trailer (it's an old SNL joke). He and his wife rent in the same neighborhood they lived in previously for $2,500 per month, more than $2,000 less than he paid for his mortgage.

Dr. C. is still in practice and is beginning to thrive in 2013, yet has $200,000 in back taxes due to the IRS. He and his wife have no savings; both are age 37.

Dr. C.'s advice:

- Don't buy a home until a couple of years after you've purchased your practice.
- Fancy cars are fancy for a long time. One doesn't need to repurchase or release every three years. The 2006 BMWs still look great and still provide prestige.
- Pay off student loans as quickly as possible. It's been 10 years and Dr. C. and wife still owe $290,000 out of the original $400,000. About 75 percent of their payments so far have been for interest.

He'd had it with debt!

Next, let's follow Dr. W., who agreed to an actual interview. Dr. W. finished his education with a DDS and orthodontic degrees from a northeast dental school in 1999. In 2000, he joined an orthodontic practice in the southeast as an associate. His student loans totaled $140,000. By 2008, his principal due on the student loan was only down 30 percent and he had purchased a home with both a first and second mortgage a year earlier.

Carlsen: In 2000, upon starting your career, what was your strategy regarding debt?

Dr. W: I didn't really have a strategy. Frankly, I just wanted to be able to make payments at first. I initially put the student loans on the 30-year plan, because I heard some older docs say that was cheap money and one should invest instead and pay them as slow as you can. We did pay off a few smaller credit card debts right away.

When and why did that strategy change?

Dr. W: It changed in 2008, when all the chaos in the economy occurred. I reread Dave Ramsey's "The Total Money Makeover," which I had initially read a few years earlier and did nothing with. At the time Dave had a nightly TV show and would occasionally get calls from physicians and dentists with large student loan balances. His advice was to wipe debt out, regardless of what anyone else says.

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I was mad that I still had a six-figure balance of loans after being out for eight years. I talked to my wife and we decided to throw everything at all of our debts, following Ramsey's "Debt Snowball" plan. I listened to his radio show and to other's success stories at wiping out debt. This helped me stay motivated.

Many general practice dentists perceive young orthodontists as having a high net income almost immediately out of school. Is this correct? What was your average net from 2000-2008?

Dr. W: As an associate I made $80,000 to $125,000, and averaged about $110,000 the first few years as an owner.

What strategy did you employ to eliminate all debt within 24 months?

Dr. W: We followed Ramsey's "Baby Steps." Step 2 is the "Debt Snowball." We listed all debts (except first mortgage) beginning with the smallest balance first, to largest, regardless of interest rate. The plan is: Attack the smallest one first, wipe it out, and take what you were paying to go after the second smallest balance and repeat the process until done. This lets you get some early wins under your belt to stay motivated.

Ramsey says personal finance is 20 percent head knowledge, and 80 percent behavior modification. Depending on your debt level, the process could take one to four years. Ramsey says to stop all retirement funding while working the debt snowball. We might have funded our IRA's one of those years, yet decided not to, via Ramsey's plan.

We started with about $10,000 on a car loan, $40,000 on a second mortgage, and $100,000 on the student loan. We wiped out the car loan pretty quickly, and then went after the second mortgage. As soon as the second mortgage was gone, we refinanced our first mortgage from a 30-year to a 15-year loan. Finally, everything was thrown at the student loan.

I think the last student loan payment was made in early 2011, a few months before I turned 40. The practice was starting to do better, which helped hammer it down. The practice was paid in full about six months later. I sure wish we started this in 2000 instead of starting in 2008!

We intend next to wipe out our mortgage as well, which is "Baby Step 6." We have committed to never having any payments again. Sure makes sleeping at night easier.

How much in personal retirement savings did you have at the beginning of your debt reduction plan and how much do you have now, even after making massive debt payments until 2011?

Dr. W: At the beginning, we had about $60,000 in our Roth IRAs. After all debt but the mortgage was paid, we built an emergency fund of $30,000, a car replacement fund of $25,000, and another $90,000 fund for our next home.

Financial Advice for the Young Dentist

Gleaned from early retiree dentists and those who have accumulated more than $4,000,000 of wealth by age 60[1]

Debt

- Always pay off credit cards completely every month. If you can't, cut them up and use a debit card.
- If you do have revolving credit card debt, pay those cards off first.
- Next, pay off any car loans. Pay cash for autos – always. The revolving lease decreases your overall savings at retirement by at least 10 percent
- Pay off your student loans. Don't go near another loan until this is paid off completely. Practice loan? Only for an incredible deal!
- Do not buy a home before purchasing a practice. The stress of starting a practice is high enough without worrying about a mortgage. Wait at least two years.
- Do not take out a mortgage for more than double your salary or net income.[2] The banks will lend you much more, yet the large house is one of the two major blocks to dentist's real wealth.

Savings

- Build an emergency fund set up of between $1,000 and $5,000 before paying down debt. This needs to be in a money market account and will help for any minor inconveniences.
- As soon as all debt except your practice loan and mortgage are extinguished, establish an adequate emergency fund of six months of home expenses. This is normally $50,000+. Put the money into money market funds. Don't get fancy with stocks, bonds or gold. This money is not an investment. It has to be rock-solid safe.
- Retirement savings: A good rule of thumb is 15 percent of your net income per year to retire in your early 60s and 20 percent to retire in your late 50s. This assumes you start saving by age 35.

Investing

I need to be blunt. You need to read two books before funding retirement savings.

- *The Little Book of Common Sense Investing* by John Bogle
- *The Only Guide to A Winning Investment Strategy You'll Ever Need* by Larry Swedroe

Then read "Do-It-Yourself Finance IV: Savings and Investing" in *Dentaltown Magazine*, March 2013.
www.dentaltown.com/Dentaltown/Article.aspx?i=316&aid=4302

Things may seem tough at times, but the dentists who follow the above principles absolutely love their practices and have little stress to burden their dreams of providing the best for their patients and families. Yes, that rush of being called "doctor" is real and is your calling. Enjoy every minute of it.

1. *Taken from interviews of several hundred clients since 2006.*
2. *Charles Farrell, J.D., LL.M., Your Money Ratios: 8 Simple Tools for Financial Security. New York, NY: Avery, 2010, page 79.*

We started a practice 401k profit sharing plan in 2010 that now has $110,000, and we plan on fully funding every year.

What have been your biggest financial mistakes?

Dr. W: The first mistake I made was buying a house with no money down six months into my associate job.

Everyone tells you that you need to buy a house right away. My parents, the senior doctor, and of course the banker, encouraged us. We should have just rented for a few years and hammered down the debt. Also, I would suggest when one is actually ready to buy, to get a 15-year mortgage, put 20 percent down, and make sure the payment is no more than 25 percent of your take-home pay. That will keep you out of trouble.

Also, I did not have a clear game plan as an associate to purchase the practice. Have both your and the senior doc's intentions on paper before you start work in the practice. I wish I had bought my practice a couple years sooner. By the way, I took out a seven-year loan to buy my practice – I am OK with that.

I bought a new car in 2005 with payments. For my next car, we will pay cash and buy a two- to three-year old used car to avoid the depreciation hit.

More recently, we set up a combined 401k profit sharing and defined benefit retirement plan. The financial advisor had us fund part of the DB plan with a whole life insurance policy. Once I saw the massive commission he made, we parted ways. Whole life policies are a rip off. We moved the plan over to Collier and Associates, since Brandon Collier teaches dentists how to keep fees low and invest on their own.

What would you recommend to young dentists?

Dr. W: Get educated! Read some books on personal finance and investing.

- I would start with Dave Ramsey's *Total Money Makeover* for some basics. I would also recommend taking his "Financial Peace University" which is a nine-week class and costs $99.
- Learn how to invest yourself with Vanguard Index Funds.
- *Millionaire Teacher* by Andrew Hallam is a quick read that covers investing with index funds.
- Subscribe to newsletters by Brandon Collier and John McGill.
- Don't lease cars.
- Get out of debt ASAP and start saving something with an automatic savings plan.
- Take the first 10 years to build a solid foundation, and then one can build massive wealth for the remainder of one's career.

Student Loan Principles

One who stretches out student loans as long as possible has two strikes against him.

1. The student loan creates a more complex debt structure, as seen in the doctor examples, making saving more difficult in the future.
2. The young dentist will buy into an insidious mental framework of debt being a natural part of life. It isn't. If you tie your identity to debt, you'll end up needing to work 10 to 15 more years than the dentist who doesn't. This is the most important message in the article. Debt is never your friend. Many will tell you to use debt for leverage, tax advantage and other ploys. Nonsense!

The only reasonable use for debt is a home mortgage and a practice loan.

What can the young dentist do with onerous student debt? Unfortunately, suck it up and live like a student for a few years after becoming a doctor. One who pays off student debt quickly will have real savings by age 50.

I know doctors in their late 40s who still have $1,500/month student loan payment along with a new home payment of $3,500/month, revolving credit card debt of $50,000 with minimum payments including interest of $1,000/month, auto leases of $1,500/month, a practice loan of $6,000 per month, and private K-12 school payments of $3,000 per month for two kids. This totals $16,500/month or $198,000 per year without paying for taxes, food, clothing, utilities, insurance, home maintenance and upgrades and DirecTV! ■

Author's Bio

Dr. Douglas Carlsen has delivered independent financial education to dentists since retiring from his practice in 2004 at age 53. For Dentists' Financial Newsletter, visit www.golichcarlsen.com and find the "newsletter" button at the bottom of the home page.

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