What Do Today’s Valuations Mean for Investors?

[Editor’s Note: The following guest post was submitted by an academic oncologist, Tomasz M. Beer, M.D. It gets way into the weeds of investing, discussing valuations and even including projections of potential future returns. Any time ideas like this are discussed, I think a few cautions should be stated up front:

First, nobody knows what is going to happen in the future. Current market valuations are not very accurate predictors of future returns, particularly short term future returns.

Second, even if you can predict future events, you must be able to predict the timing of such events well enough to capitalize on the event in order for the information to be actionable. Timing an exit AND a reentry well enough to overcome the costs is not an insignificant task and perhaps not even possible for the vast majority.

Third, if you really believe that future returns will be low, you want to consider both the likelihood and the consequences of you being right...or wrong.

Fourth, a pessimistic outlook on future asset returns should indeed, as Dr. Beer will point out, lead you to make different
decisions, primarily spending less and working longer. Even paying back low interest rate debt for a guaranteed return becomes more attractive if you don’t expect much from stocks and bonds. The risks and hassles of alternative asset classes such as real estate and small businesses may also be less onerous.

Fifth, beware of perma-bears. The idea that “valuations are high” and “future returns will be low” is neither new nor specific to 2019. Similar concerns were raised by none other than Wade Pfau, PhD, CFA in 2013 as I wrote about here. Over the last 5 years, the Vanguard Total Stock Market Fund has had an annualized return of 10.33% per year, including the very brief December bear market.

For all of these reasons, I prefer using a fixed asset allocation held through thick and thin, and then simply accepting what the market provides. Dr. Beer and I have no financial relationship. Enjoy the article.

**Investment Outlook**

Today’s market conditions require careful consideration. Asset prices are high and return expectations are unusually low. While nobody can predict the movements of the markets in the short term, one can estimate long-term returns going forward, for example for the next decade based on known variables and historical data. Many investment houses offer their investment outlook. Vanguard’s is one I read annually.

**Bonds**

Long term returns from bonds, provided that they are held to maturity, equal the coupon rate less default losses, and for US Treasury securities, just the coupon rate. Presently Treasuries are offering a yield of 3%, Investment grade corporate bonds 4%, and TIPS are offering close to a 1% real rate of return. Default rates on investment-grade corporate
bonds historically approximate 0.1% per year and long-run historical returns of corporate bonds have exceeded those of Treasuries. However, corporate bonds prove to be a poor buffer against economic crisis, when Treasuries shine due to the “flight to safety” behavior of investors.

**Stock Market**

Long term stock returns may be estimated as the sum of dividends and the compounding effect of their reinvestment, earnings growth, and changes in the relationship between stock prices and corporate earnings (PE ratio). Stock repurchases are not a large factor market-wide as repurchases by some companies are counterbalanced by issuances by others and for any given company, the effect of a reduction in outstanding stock is reflected in that stock’s earning per share. Currently, for the US market, the dividend yield is under 2%, the long run earnings growth rate has been 4 to 5% and is composed of approximately 2% real growth and 3% growth attributed to inflation. The price to earnings ratio of US stocks is very high by historical standards and while the future cannot be predicted, it appears more likely than not that reversion to the mean will subtract from stock returns over the coming decade.
10 Year Expectations

Using these data and considering a long run inflation expectation of 2 to 2.5%, one can propose the following 10-year market returns for various major asset classes, largely modeled after Vanguard’s analysis. The risk estimates are merely qualitative and reflect my views. My view of stocks’ poor ability to protect from inflation is based on their performance in the 1970s and refers to a 10-year time frame. In the very long term, earnings go up with inflation and stock prices must follow. But in the near term (a decade being the near term), stocks compete with rising interest rates on bonds and therefore inflation may accelerate PE compression which would hamper stocks’ ability to protect from inflation.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Nominal Expected Return</th>
<th>Real Expected Return</th>
<th>Risk of loss of principal</th>
<th>Risk from inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Stocks</td>
<td>4% (3 – 5)</td>
<td>1.5-2%</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>International Stocks</td>
<td>6.5% (5.5-7.5)</td>
<td>4-4.5%</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>US Treasury Bonds</td>
<td>3%</td>
<td>0.5-1%</td>
<td>None</td>
<td>High</td>
</tr>
<tr>
<td>US TIPS</td>
<td>3%</td>
<td>1%</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>US Corporate Bonds</td>
<td>4%</td>
<td>1.5-2%</td>
<td>Medium</td>
<td>Medium</td>
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<tr>
<td>TIAA Guaranteed</td>
<td>4%</td>
<td>1.5-2%</td>
<td>Low</td>
<td>Medium</td>
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What Do These Valuations Mean for Investors?

So, what are the implications of this situation for various investors? First, I would like to draw some distinction between market timing and age or situation-appropriate asset allocation. Some of my comments reflect the fact that young, middle-aged, and older investors have different levels of risk tolerance and different investment horizons. These distinct situations require different portfolios with different risk and return expectations. However, one could make a case that there are times in history when some adjustment based on market conditions is also warranted. Those times are times when risk is not being properly rewarded. The table above suggests that we may be facing such a situation now.

Tomasz M. Beer, M.D

The expected total return from US stocks and from US corporate bonds is about the same. While bond prices can fall with rising interest rates, the total return of bonds held to maturity does not change and one might speculate that a significant rise in interest rates would put pressure not only on bond prices but similarly on stock prices. Recession, on the other hand, might increase corporate bond defaults but would also result in falling interest rates and therefore rising bond prices. Thus, these return expectations, at least
in relation to one another, should withstand the expected range of interest rate fluctuations.

**Young Investors**

*Young investors* have it relatively easy. Poor returns early in someone’s investing career, provided regular contributions continue through thick and thin, and particularly if they increase over time, should have relatively little impact on ultimate outcomes. This is especially true for investors with a truly long investment horizon, for example, 40 years.

Such investors should regularly contribute towards a portfolio that is heavily weighted towards equities, both US and international. And they should hope for a market decline. History teaches that sooner or later, this hope will be realized and these investors will have the opportunity to add stocks at bargain prices. Such a price correction would also alter the relation between expected returns for asset classes and restore the equity risk premium back to a level where it belongs.

**Middle-Aged Investors**

Investors in their 40’s and 50’s and also older investors who have not built their nest egg yet, are at greatest risk of being damaged by the current situation. These investors are in their peak earning, saving, and investing phase of life. They need the strong returns that markets have historically delivered to build adequate retirement savings.

**Reduced Returns**

Consider that a stock market return of 10% applied to a 30-year investment horizon would produce a bit more than 4 doublings of an initial investment. Every $10,000 invested at 10% for 30 years produces more than $160,000. This sort of return is what makes it possible for Americans to retire
securely. When that annual return is reduced to 5%, we can expect 2 doublings, yielding only $40,000. Thus, the difference between 10% and 5% is staggering when applied for an extended period of time.

Inflation

The picture gets even worse when one subtracts a 2% rate of inflation. The real rate of return then drops to 8% and 3% respectively. And a 3% real rate of return means that the value of an investment held for 30 years barely more than doubles in real terms. Meanwhile, the real value of an investment exposed to a real rate of return at 8% goes up more than 8-fold.

Things may not be quite so dismal because present conditions may not persist for the entire remaining investment horizon of these investors. Estimates of expected returns are constructed around a 10-year horizon. Forecasting beyond that is an impossible task.

Changing Market Conditions

At some point during the investment life cycle of these individuals, market conditions may change (likely through a correction in stock prices). Investors who are diversified can take advantage of such shifting conditions through
rebalancing and enjoy the subsequently improved returns, although they will sustain some losses through such events. Indeed, the sooner such a correction comes, the better for these investors.

**Portfolio Diversification and Allocation**

So, what should folks in this situation do? First, stay diversified, and consider adopting a portfolio that would traditionally be considered more conservative than would be typically recommended. A higher allocation to bonds would enable these investors to rebalance to stocks when opportunities arise while limiting damage from a correction. It would also capture much of the expected return with less volatility.

This is, of course, a form of market timing, but one that is founded in fundamental analysis of market conditions. Put another way, when the expected return of stocks, which represent second-position claims on corporate earnings approximate those of corporate bonds which are entitled to corporate assets ahead of equity owners, the argument for stock ownership gets weaker. Abandoning stocks altogether would be imprudent given their diversifying role and their potential for growth, and the fact that no one can truly anticipate the future and it may look different than our current expectations. But a reduced allocation to stocks, at least US stocks, may be prudent in 2018.

**Saving or Working Longer**

Saving more, working longer, and planning for part-time work during retirement is the advice offered by many respected financial thinkers. For many Americans, saving more may not be realistic. More money means a reduction in the current standard of living. If market returns are low for a very long time, the savings commitment would have to be increased
substantially, likely beyond the capacity of most investors. Saving more is a good idea, but may not be sufficient nor feasible.

Working longer or working during retirement is everyone’s plan B but should not be the plan A. Some people are passionate about work and foresee working well into retirement age. They may change their mind when they are older. Or they may continue to feel that way. Having the option to extend one’s working career is a great thing. But having no choice is not. For many Americans working longer may not be a realistic option. Deteriorating physical health, cognitive health, or just aging can make it hard to work late in life. Jobs may not be available. And it is not possible to know in advance if working longer will be either feasible or desirable. Working longer may prove necessary, but that needs to be the back-up, not the primary plan.

**Seek Higher Returns With Alternative Investments**

The alternative is to seek investments with higher returns. This is risky, hard, and requires work. But it may be the only way. I am not suggesting investing in obscure market segments that can collapse, cryptocurrencies, or other investment that are associated with excessive risk.

Within the securities markets, much is written about “factor investing” such as tilting the portfolio in favor of smaller stocks or value stocks or other factors. These factors have outperformed the overall stock market over extended periods of time and have done so with greater volatility. Because they appear riskier, many authors believe that over the long term they may continue to outperform, that the outperformance represents the risk premium, compensation for greater volatility. Critics suggest that with growing awareness of the historical advantage of these market segments, the advantage may not be repeated.
It is impossible to know what the future will bring. My view is that such portfolio tilts may bring a bit of extra return (but not enough to raise the expected return all the way up to the 10% or so that the overall market has historically provided), but if they do, it will be accompanied by greater risk. At a time when risks in the stock market are already elevated, investors must consider the possibility of greater losses or tilting their portfolio to small and value stocks.

While many assets are priced high today, this is particularly true of marketable securities. Marketable securities command premium pricing in part because they offer immediate liquidity. Immediate liquidity is not an important attribute for investors with a 20 or 30-year time horizon. The ability to liquidate assets when the capital is needed is, of course, important, but with planning, investors can manage through complex liquidation transactions.

Investors may be able to realize greater gains by giving up liquidity – and investing sweat equity. Perhaps that is a second home that is rented out long term – or through a short-term rentals platform. Or perhaps a duplex or a small apartment building. Commercial real estate can be found at CAP rates of 5 to 6. With careful leverage, tax advantages, and reinvestment in the property through principal repayment, higher rates of return are possible. Perhaps there are some
other passive income investments that this investor is familiar with and capable of managing. Perhaps the investor is in position to purchase a profitable small business and operate it.

Such investments are riskier and require knowledge, skill and some luck. William Bernstein says that rental real estate is not an investment, it’s a job. And he is not wrong (although at a certain scale, one can pay others to manage it). Real estate can become overheated, recessions create significant stress for landlords. Buildings can sit empty between tenants. It is not an easy road. But there are ways to start slow, learn, and build.

A single-family home in a stable market that can generate sufficient rent after expenses to cover the debt service may be a place to start for many people. Low leverage ensures that one can withstand reduced rents in a recession. Adequate cash reserves to weather the unexpected should be a part of such a strategy. The below example summarizes returns on a single-family home investment based on stated assumptions.

**Example 1:**

A single-family home purchased with 25% down using a 30-year mortgage at 5% that is capable of generating rental income sufficient to cover all expenses.

The purchase price would need to include all necessary improvements to rent the home out. And rental income would need to cover not just the mortgage and taxes, but truly all expenses, such as insurance, repairs, vacancy, improvements, management fees, etc. If such a house appreciates at 2.5% per year, basically the rate of inflation, the combination of appreciation, loan repayment of principal, and leverage would produce an internal rate of return (IRR) of 11% per year over 10 years, this without any cash income from the property.
There are many parts of the country where it is not possible to buy a house whose price is sufficiently low and rental income sufficiently high to achieve this, but there are places where it is possible. And the assumptions are reasonable and fairly conservative and include a margin of safety.

For example, if an unexpected expense equal to 10% of the purchase price is needed mid-way through the investment period, the IRR is reduced to a respectable 8%. If the property does not appreciate at all, the debt repayment alone generates an IRR of 5%.

Owning a rental house adds work and stress and is not a guaranteed investment. But purchased at a reasonable price and managed well, it is an investment that has a realistic potential of generating a return near 10% per year. The same math applies to duplexes, small apartment buildings, etc.

Example 2:

A NNN single tenant property with a long term lease with a highly reputable and financially strong tenant purchased at a CAP rate of 6 with 30% down using a 20-year mortgage at 5.5%.

If such a property appreciates at 2.5% per year due to scheduled rent increases, the combination of appreciation,
loan repayment of principal, and rental income would generate an internal rate of return (IRR) of 13% per year over 10 years. Even if purchased without any leverage – with cash – such a property would generate a 10% IRR over a 10-year holding period. Higher leverage and better financing terms would yield higher rates of return.

Such properties are leased to fast food restaurants, retailers, and other similar tenants. You likely drive by many such properties every day. They may prove fairly easy to operate with very long-term leases and all operating responsibilities resting with the tenants.

The principal risks involve the fate of the tenant or the retail location. Some of these properties are built to suit a particular tenant and if that tenant falters, the owner may struggle to re-lease the property or may need to modify it extensively. Long term changes in the market are hard to anticipate and some tenants or some locations that are strong now may not thrive for the next 20, 30, and 40 years. A prolonged vacancy in a single tenant property could be quite impactful. Properties that are in strong location and would be in demand by other tenants are less susceptible to such risks.

NNN properties offer a bit higher rates of return than single-family homes and potentially involve less work. But they do come with greater long-term risk. If your tenant goes out of business, the property may lose quite a bit if its value if it cannot be re-leased at similar rates.

Not everyone is willing to undertake such ventures. And there may be other similar opportunities for some investors. But with return expectations in the securities markets unusually low, less liquid investments with higher potential returns deserve consideration. One can start slow and learn, for example by subletting one’s basement room to try one’s hand at being a landlord. One can also pursue such opportunities with a partner. Partnerships can be challenging at times but good
partnerships bring together trusted people with complementary skills and abilities and double the wisdom and judgment and half the work. Think of Walt and Roy Disney or Larry Page and Sergei Brin.

I am not suggesting that middle-aged investors swing for the fences or take risks they cannot manage. Hard work is likely to be required to find such opportunities and execute on them. There is, of course, incremental risk in engaging in such investments. This risk should be considered in the context of an overall portfolio. Perhaps a more conservative allocation between stocks and bonds in one’s securities portfolio can buffer the risk of an illiquid investment, just as it would a higher allocation to stocks.

For those with much energy and expertise, buying an established, profitable small business could be another option. Private equity firms do this all the time. Small investors can too. Running a business can be hard work and small businesses fail often. This is a high-risk endeavor. But I am not talking here about starting a business from scratch, the higher risk venture. I am referring to buying an established, operating business that has a track record, a customer base, and strong management. Not for the faint of heart, such investments can yield substantially higher returns when things turn out well. Consider that small businesses
trade at 5 to 7 times earnings, far less than common stocks. [Editor’s Note: Online businesses can trade at even lower valuations–2-3 times earnings–but there’s a reason for that!]

**Example 3:**

A successful, profitable small business purchased at 6 times earnings with 50% down using a 10-year loan at 7%.

If such a business can grow earning approximately 5% per year (the same assumption as the overall stock market), the combination of appreciation, loan repayment of principal, and business income would generate an internal rate of return (IRR) of 37% per year over 10 years. Even if purchased without any leverage – with cash – such an asset would generate a 27% IRR over a 10-year holding period.

Small businesses are hard work and they can and do fail. When earnings shrink, the value of small business plummets. A business without profit is worth little more than its assets or less if it has liabilities like lease obligations or severance packages. Small businesses are hard to operate on a small scale. Large investors can absorb the costs of management, accounting, marketing, etc., and spread these out over many locations. Owning a small business is no easy task. On the other hand, experienced business operators can improve business performance and rapidly generate outsized returns. Fortunes are made by highly skilled and well capitalized operators who acquire under-performing businesses and apply their skills and capabilities to improve performance.

This is not an exhaustive list of ideas, but instead some examples of the sort of endeavors that enterprising investors can consider for a portion of their portfolio.
Older Investors

For those nearing retirement or in retirement already who are fortunate enough to have accumulated sufficient assets, an extended period of poor returns or losses early in retirement is the greatest threat to their plans. We do not know the future, but current market conditions suggest a high probability of lower than historical returns and relatively poor compensation for running stock market risk. Perhaps the adage that, “when you have won the game, stop playing” is worth remembering.

If the assets are truly sufficient to fund retirement, risk needs to be reduced. William Bernstein emphasizes asset-liability matching as a strategy and reminds his readers of rare but potentially catastrophic risks as well as the ordinary market volatility. Using safe assets to fund specific financial needs at specific times can risk-proof one’s retirement. This necessarily means accepting lower returns.

The safest assets are US Treasury securities, including inflation-linked bonds that provide a modest but guaranteed real return. A ladder of Treasuries or TIPS can be constructed to cover at least some minimum level of retirement financial needs, for example. If assets remain, these can be invested in riskier assets.

Alternatively, purchasing an immediate annuity from a strong insurance provider can result in guaranteed income and supplement other guaranteed income streams like Social Security. The risks associated with the failure of the insurance company that is selling annuities, while low, should also be considered, particularly in light of the long time horizon ahead for many retirees.
At the very least, a more conservative portfolio allocation when the expected returns from US stocks is not substantially different from the expected return from investment grade US corporate bonds is worthy of consideration. A focus on capital preservation is appropriate for those retiring with current market conditions.

What do you think? Do current valuations impact you how you invest? What about how you spend, how long you work, or your debt vs investing dilemmas? Comment below!

401(k) Loans Are Not An Investment

Should I Borrow Against My 401(k) to Get Bond-like Returns in it?

Q. We took maximum loans against our individual 401(k)s because we knew our jobs were VERY stable. We charge ourselves the maximum interest, paying the loan back with after-tax money obviously. Since the interest rate is more than current
bond yields, we feel this would be a good investment. I might miss bigger returns by not investing in equity market, but I have a higher yield than the bond market, and feel like I am exposed to less volatility risk. What do you think?

The Return is 0%. That Is NOT Bond-like.

A. You’re not the first to think of this. Given the interest rates on 401(k) loans are Prime (currently 5.25%) + 1-2%, a guaranteed return of 6-8% on 401(k) money can seem pretty attractive. However, what you must realize is that the return on investment here is not 6%, it’s 0%. The reason why is that you’re paying the interest yourself. You pay 6% to yourself. So you pay 6% and you receive 6%. There’s no extra 6% there. 6% – 6% = 0%. You had the same amount of money you had before. Let me explain.

- Imagine you had $10,000 in your 401(k) and $600 in a taxable account, for $10,600 total.
- Now you borrow $10,000 out of your 401(k). You now have $0 in your 401(k) and $10,600 in your taxable account, for $10,600 total.
- A year later, you pay the $10,000 back to your 401(k) along with the $600 in interest. Now there is $10,600 in
your 401(k) and $0 in your taxable account, for $10,600 total.

Where’s the investment return? That’s right. There isn’t any. Don’t believe me because I’m just a doc? Would you believe Michael Kitces?

Technically it does allow you to put more money into your 401(k), since all of the interest paid does actually go into the 401(k). However, it’s even worse than a non-deductible IRA. Not only do you not get a deduction for that interest paid into the 401(k), but it doesn’t even increase the basis of the 401(k). You put after-tax money in, but when you take it out you have to pay taxes on it! That’s a lousy deal. Essentially, that money paid as interest would be taxed twice.

Besides, even if this were a good deal, it would be a pretty limited one. You can only borrow out half of your 401(k), up to a total of $50K. So assuming only one 401(k) for you and one for a spouse, this would only work for $100K of your portfolio. That’s a significant chunk of a $500K portfolio, but not of a $5M one.

401(k) Loans Are Not Double-Taxed

Please note, however, that 401(k) loan PRINCIPAL is not double-taxed, only the interest paid on that loan is taxed twice (once when you earned it at your job and again when it is withdrawn from the 401(k). This has been well-explained here, here, and here. Note that if you borrow from the Roth side of the 401(k), that double taxation doesn’t occur, making the “deal” slightly better (although the return is still 0% and you’ve now lost the opportunity cost on a larger amount of after-tax money to get the same size loan.)
401(k) Loans Not As Bad As They Used To Be, But Still Bad

401(k) loans used to be really bad. If you had an outstanding loan and were fired or left the job, you had to have it paid back within 60 days or it would not only become taxable income to you, but there would be a 10% penalty due to the IRS. Thanks to the tax law changes made at the start of 2018, you now have until your tax return is due (including extensions) to pay the loan back without penalty. So if you took out a loan on January 15th of 2019 and then quit your job, you could have up to 21 months to pay it back. That’s good, since about 10% of 401(k) loans were never paid back prior to the law change.

So if paying prime + 1% to your 401(k) provides a much lower interest rate than any other option you have, a 401(k) loan might still make some sense. However, a rule of finance is that those who receive interest generally come out ahead of those who pay it. That fact doesn’t change just because you’re borrowing your own money. There is a cost there and it’s the same cost whether you spend cash you have, spend a bank’s money, or spend money borrowed out of your 401(k). It’s opportunity cost. Money used to consume can’t be invested at the same time. (Technically there is an exception to that, but the downsides of that technique often outweigh the upsides.)
Those who receive interest generally come out ahead of those who pay it. That fact doesn’t change just because you’re borrowing your own money. There is a cost there and it’s the same cost whether you spend cash you have, spend a bank’s money, or spend money borrowed out of your 401(k).

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**One Good Reason For a 401(k) Loan**

I can think of one good reason to take out a 401(k) loan. If your 401(k) sucks and you can’t get your employer to improve it, you can still contribute to the 401(k), then borrow the money (up to 50% of balance or $50K, whichever is less) out of it and invest it elsewhere. If your only choices are crummy 3% ER loaded actively managed mutual funds, that could be a good idea. Note that the 401(k) has to be REALLY terrible for you to come out ahead, since you’re basically now investing that money in a taxable account where tax drag (from capital gains distributions, dividends, and interest) occurs. If your 401(k) is really that bad, you might be better off leaving articles like [this one](#) around the office anonymously.
The bottom line is that there is no free lunch with a 401(k) loan, so don’t kid yourself that you’ve discovered one. If you have to borrow money, it’s not the worst way to borrow it, but I wouldn’t make a habit out of it.

What do you think? Have you used a 401(k) loan? Why or why not? Comment below!

Build Your Real Estate Portfolio with the BRRRR Method

[Editor’s Note: The following article is shared today from WCI Network partner, Passive Income MD and is about using leverage to grow a real estate portfolio.]

Physicians are huge fans of using acronyms – SOB, CHF, CABG, COPD, PE . . . these are just a few off the top of my head. In these cases, they stand for conditions none of us would like to have.

Of course, acronyms run rampant in other industries as well. There are tons of them in the real estate investing world, for example, and I’ve talked about some of them before, like CoC. One of my favorite acronyms, however, is BRRRR. It’s a real estate investment strategy that people love to use, and here’s
I’ll cut to the chase. The point of this strategy is to help you acquire and build a portfolio of cash-flowing properties with little or no additional capital after purchasing the first investment property.

What does that mean? Well, let’s say you’ve diligently saved up for a rental property and maybe it’s taken you a while to accumulate the amount for a down payment. You know you want to purchase a second property but saving up from scratch again will likely take you a while. However, what if you were able to acquire that next property without having to save up all those funds again? That’s the point of the BRRRR method.

No, it’s not a get-rich-quick scheme, but it is a strategy that many people have used to build up a nice passive income portfolio without having to save a ton for a down payment each investment.

Many physicians ask how to go about acquiring rental real estate, especially early in their career when additional capital is difficult to come by. If you’ve wondered this as well, then join me as we go a little deeper into what this method is all about.
Buy

An old proverb of real estate investing is that you make money when you buy. Find a good deal and you’ll set yourself up for future financial success. Buy poorly, and actually making money becomes a long, difficult road.

This is true, but don’t get so caught up trying to find the perfect investment that you never end up buying anything (analysis paralysis). Yes, good investments can be difficult to discern, but that’s why it’s important to learn how to evaluate properties and work with real estate numbers. Your first buy will be the hardest, as they say, but afterward, you’ll have the experience and confidence to make further wise investments.

What is the goal of this purchase? It’s to buy a property that you think ultimately has some upside potential or is undervalued – it could use a little fixing up, or is in an improving area. Just so you know, the goal isn’t to flip the property, which I don’t do. In fact, the plan should be to hold onto it indefinitely (or at least for a while). The buy and hold mindset is absolutely different than someone looking to flip a house quickly.

You’re most likely going to use financing for this purchase. For an investment property, lenders will typically want you to put down at least 20-25%. You’re going to want to make sure you at least have that amount in cash as well as some extra to cover closing costs and reserves for this first property.

Rehab
The idea is simple – after purchasing the investment property, fix it up in a way that makes it livable and increases the value. Of course, you probably won’t want to get a home that requires the amount of rehab you see on those home-flipping shows on HGTV, but maybe a property that could use a little freshening up.

Examples of rehabs that add value include fixing the kitchen with reasonably priced additions, paint, changing out the carpet for hardwood floors, fixing up the bathrooms. It also needs to be doable in a way that doesn’t consume all of your time for the foreseeable future.

Knowing where to get the most bang for your buck in terms of rehab is something that comes with experience and having a good contractor.

Rent

In order to refinance a rental property (this step comes next), banks will want to see that it is producing income. So you’re going to want to fill it with good tenants after you rehабbed the property.

How do you find good tenants? Well, there are no guarantees, but it’s important to screen diligently and be strict about it. I’ve learned the hard way with my apartment building. Relax your standards, like credit score, or be lazy about
calling references, and you can get burned pretty badly.

Then there’s the question of hiring a property manager. Whether you should or shouldn’t is a personal decision. Most of the time, I think it’s in your best interest. Sure, you’d be saving some money and increase your cash flow, but your time as a busy professional is worth something, in fact, it’s worth quite a lot.

People say you average about five to ten hours a month managing a property. That doesn’t seem like much, but for high-income professionals, those hours can be worth quite a bit. Especially if the alternative is doing something that you love, like spending time with your family.

So find good tenants, make appropriate assumptions about expenses and hopefully, it’ll cash flow for you.

**Refinance**

The next step involves refinancing the property, and there are a few things to consider.

First, the seasoning period. Before they’ll refinance the property on the appraised value, banks will look at how long you’ve owned the property, as well as how long it’s been rented out. At a certain point, the bank considers the property “stabilized.” But what is that point?

Some banks are apparently willing to refinance immediately after rehabbing and renting out the property and base the loan on the appraised value. However, for the most part, a typical seasoning period is at least one year of ownership.
Once you’ve reached that point, how do you find a good bank? Most of us only think of the large national chains that are sitting on the major street corners. However, there are so many different smaller and local banks looking to fund investors—if the deal makes sense. You should ask around on forums, and frequent real estate investor meetings to find out.

Lenders will typically loan up to 75% of the appraised value of the property. For example, if the property appraises for $160,000, they will let you refinance and take out a $120,000 loan.

Repeat

By now, you should’ve received some cash from the refinance after taking a loan for 75% of the appraised value and after paying off the original loan. This helps free up capital, which enables you to go and purchase another property. It’s one way to help you grow and build a portfolio of rental properties without having to continually save up a large amount of capital.

Just repeat the cycle to continually purchase and recycle capital. People use this strategy with all types of rental properties, from single family homes to duplexes, to quads, and even apartment buildings.

Example of the BRRRR Method

Here’s an example of what some of the numbers may look like using this method. Disclaimer, this is a very simplified model. (Did not include fees, taxes, mortgage pay
BUY a property for $100,000
- Down Payment of $25,000
- Take out a loan for $75,000
- REHAB property with $20,000

Total Investment of $45,000 (Down payment + Rehab Costs)

- RENT out the property for $1200/month.
- REFINANCE the property for an appraised value of $160,000 a year later.
- The bank allows you to take out a loan for 75% of the appraised value ($160,000 x .75 = $120,000).
- Take the $120,000, pay off the original loan for $75,000 and that leaves you with $45,000 in cash (the same as your initial investment) to go out, REPEAT and find another property.
- In the meanwhile, you have one property under your belt that is cash-flowing already.

This is an example using a smaller property, but people buy multifamily properties all the time with this method using large numbers, cash out refinance, and use the funds to purchase the next property.

In fact, this is the strategy my partner and I are considering for purchasing another multifamily property in the future.
Pros and Cons of the BRRRR Method

As with anything, there are some upsides and downsides to the BRRRR method.

Pros

- Don’t have to wait to save up the down payment and repair capital for each property. You can save up for it for the first property and use the money from the refinance for future purchases.
- Helps you to build a nice real estate portfolio relatively quickly depending on how soon your refinance
- Build and force equity

Cons

- If the property doesn’t appraise well, it could be an issue refinancing and getting anything back
- Tough in a down market
- Have to deal with the hassle of rehab
- With each refinance, you strip the equity down to 25% so all your properties will stay relatively highly leveraged
**Conclusion**

The BRRRR method is a powerful way to grow a portfolio. Normally if you want to buy multiple properties, you have to save up each time for the down payment as well as any money for the rehab. If they’re smaller purchases like those in my example of *Buy a Property a Year and Retire Early*, you’ll likely be able to save up for the down payment each year.

It just goes to shows that with real estate, there are multiple ways to be clever using leverage and strategy. But of course, you have to be smart and plan for contingencies just like with any other investment.

*Have you used the BRRRR method? Does it sound like a good way to build a real estate portfolio?*

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**401(k) Vs HSA: A Showdown**

I’ve long made the contention that a Health Savings Account (HSA) is the best investing account. Today, for the first time on this blog, we’re going to put some numbers to it. We’re going to throw a HSA into the octagon with a 401(k) and see who comes out on top. Two accounts go in, but only one account comes out on its feet.

**The 401(k)**
First, in the South corner wearing the red trunks we have the staple of the current American retirement system, the 401(k). Founded in 1981, it provides for tax-deferred (or Roth) employee contributions of up to $19K per year ($25K if 50+) plus the opportunity for employer match or profit-sharing contributions up to a total contribution of $56K per year. It provides the largest tax break available for most doctors and protects their retirement assets from their creditors and the taxman as it grows.

Depending on the employer, it may suffer from high fees and crummy investment choices. You also may not be able to transfer the money away from the employer until you quit, are terminated, retire, or die. The 401(k) allows you to borrow up to $50K (or 50% of the balance, whichever is smaller) from it. Additionally, you can roll your 401(k) over to an IRA which, if left to heirs, can be stretched for additional decades. Although there are a few exceptions (including early retirement) if you want to access the money prior to age 59 1/2, you will owe a 10% penalty in addition to any taxes due. Clearly, a 401(k) is a formidable champion when it comes to investing accounts.

The HSA

However, our challenger, wearing blue trunks in the North corner, is no slouch. Camouflaging its true purpose with the
name Health Savings Account, this Stealth IRA packs a real punch. Fresh on the scene in 2004, it provides for triple tax-free contributions of up to $3,500 ($7,000 family) per year but does require the use of a High Deductible Health Plan.

Although not the largest account out there (neither is the 401(k)), it is like a wolverine that punches way above its weight. Not only do you save income taxes when you contribute, but if the contributions are taken directly from your paycheck by your employer, you also save payroll taxes. In addition, so long as you spend the money on health care, you can withdraw money from the account tax and penalty-free at any age. HSAs shield investments from the taxman (although probably not from your creditors) as they grow over the years. You also can pull the money out of the account years after the health care expenses without tax or penalty as long as you keep receipts. Although the penalty for pulling money out of the account inappropriately is higher (20% for non-health care expenses before age 65), after age 65 its tax treatment is no worse than an IRA or 401(k) (thus the term Stealth IRA.)

It’s a lousy account to leave to heirs (probably the worst thing possible tax-wise), but since it can be used to pay for Medicare premiums and the other hundreds of thousands of dollars in health care expenses most seniors face, that shouldn’t be too much of an issue. If your employer’s provided
HSA plan stinks, you can roll the money over to your own chosen plan once per year.

Let the battle begin.

401(k) vs HSA: the Head to Head Competition

Let’s say you have $7,000 to invest, but you’re not sure whether to put it in your 401(k) or your HSA (and for some crazy reason can’t max out both accounts.) Which account is going to be most advantageous to you?

Initial Tax Break

Assuming a 35% marginal tax rate, if you contribute $7K to the HSA, you save $7000 * 35% = $2,450 in federal/state income taxes. But you also save payroll taxes. For a typical employee doctor, this is just going to be 1.45% in Medicare, or another $102 for a total upfront tax break of $2,552.

If you contribute that same $7K to the 401(k), you only save the $2,450 in income taxes. But wait, what if there’s an employer match? Let’s say your employer matches up to 25% of the first $4000 you contribute to the account each year. That means there is now $8,000 in that 401(k).

Advantage: 401(k), but only if there is a match.

Available Investments
It might be hard to get hurt in three foot deep powder, but should it happen, you’ll prefer an HSA to a 401(k).

Your unenlightened employer doesn’t offer particularly good investment options or fees in either account. However, at least with the HSA, you can roll the money out of the account once a year to a plan with better investments and lower fees. Let’s assume the 401(k) money grows at 7.5% and the HSA money grows at 8% per year over the decades. I thought 0.5% was a reasonable average additional fee for plan fees and higher ER mutual funds. That may overstate or understate the case for your 401(k).

Advantage: HSA, but could vary by employer

Need Money Now

Uh oh. Something has come up. You need cash. Which account should you tap? Well, withdrawing from the 401(k) incurs taxes and a 10% penalty. Withdrawing from the HSA incurs taxes and a 20% penalty. You can borrow against the 401(k), but the terms aren’t that hot with a fairly high interest rate. Luckily, you spent a few bucks on health care this year and have some receipts saved up, so you can actually withdraw the needed money from the HSA tax, penalty, and interest-free.
Advantage: HSA

Creditors Come Knocking

There’s a potential suit above policy limits. Your state protects your 401(k) in bankruptcy but provides no such protection to the HSA. Luckily, like happens almost all the time, on appeal, the judgment is reduced to policy limits and you lose no personal assets.

Advantage: None

Time to Withdraw Money In Retirement For Health Care

11% Annual Returns. Invest in Real Estate Online

Find Out How

Now you’re 70 and need to pay some health care expenses for recent cancer treatment. Where should you take the money from? If you take it from the 401(k), you’ll owe taxes at your ordinary income tax rates. If you take it from your HSA, the withdrawal will be tax-free. Just how much of an advantage does the HSA have here? Let’s run the numbers.

We’ll add that original Medicare tax savings into the HSA total for simplicity and the match into the 401(k), then apply 30 years of compound interest.

\[ \text{HSA: } = \text{FV}(8\%, 30, 0, -7102) = 71,464.99 \]

Multiply by \(1 - 0\%\) for taxes and you end with $71,465 to spend on health care.
401(k): $70,039.64 Multiply by 1 – 25% for taxes and you end up with $52,530 to spend on health care.

Despite the employer match, the HSA ends up with 33% more money. You can buy a lot of health care with an extra $19K, especially if you multiply that by 20 or 30 years of HSA contributions.

Advantage: HSA

**Time To Buy A Sailboat**

With your cancer scare over, it’s time to get out on the bay in a new sailboat. Which account will provide a larger sailboat? Let’s run those numbers again:

HSA: $71,464.99 Multiply by 1 – 25% for taxes and you end with $53,599

401(k): $70,039.64 Multiply by 1 – 25% for taxes and you end up with $52,530

The HSA wins, but not by much.

Advantage: HSA

**Game, Set, and Match to the HSA**
As you can see, in the vast majority of comparisons, the HSA is going to come out on top as the best of the two investing accounts. Even when it is not superior, it is typically about the same as or not much worse than the 401(k). And when it is superior (paying for healthcare before or during retirement) it is dramatically superior thanks to its triple tax-free nature. That said, a 401(k) is still a very good place to invest and ideally, you’ll be able to max out both and even invest in a taxable account above and beyond your tax protected accounts.

What do you think? Which do you think is the best investing account? What is the first account you fund each year? Comment below!

How to Passively Invest in the Vacation Rental Market

[Editor’s Note: This guest post was submitted by Stephen Sorenson, who enjoys a double life as a tech professional and a real-estate developer. He and his wife have operated a vacation rental property development and management business since 2003 called Classy Cabins AZ. In this article, he attempts to make the case for investing passively in vacation properties. While I’m not sure I was convinced, I think it is a worthwhile conversation to have, so I’ve turned it into a bit of a Pro/Con post. We have no financial relationship.]

Pro: Vacation Rentals Are a Great
As a busy professional, you may have little time to spend as an active investor. Whether it’s doing research in the stock market or bond market or looking at real estate, there is a substantial time commitment. Even the time necessary to meet with financial advisors, then weed through their offerings to decide if they are for you is heavy. It’s also a fact that you should invest as early as you can to let the magic of compounding work. And then invest regularly. It all adds up to quite a bit of time and energy.

Fortunately, now is a great time to be interested in “passive” investments as there are many more choices than there used to be. In fact, you can find ways to invest passively in nearly any asset class from stocks and bonds, to durable equipment, to various kinds of real estate. There have been big changes in many markets as technology advances. In the stock market equities field, there are now fully automated systems that allow you to place money in the system, and just let it do what it does after you indicate some basic preferences. Or, you can simply invest in index funds or ETFs. But, if the stock market just isn’t your cup of tea, perhaps real estate is better. It’s been said a zillion times, but it’s true; more wealth has been amassed through real estate than through any other class of asset.

Recently there has been a spate of changes in nearly all real
estate markets. For active investors, and for passive investors supporting those activities, *fix & flips, fix & hold, and other strategies* are immensely popular. How many other kinds of investments have so many reality TV shows devoted to them? But popularity brings with it a lot of players. Competition always puts pressure on returns and today, that kind of investment is extremely competitive with billions of dollars of both domestic and foreign money snapping up properties and bidding up the prices as they go. So, what happens when a particular segment gets really crowded? Investors start looking for other places to do what they do.

**Vacation Rental Market Trends**

In just the past dozen years, vacation rental properties have undergone huge and fundamental changes, and just in the last few years have attracted the attention of investors of all stripes and sizes from Mom & Pop to Institutional investors. What’s happened? What’s driving the changes? And more importantly, are there great opportunities there?

**Rise of the Internet**

Our business started 14 years ago with our first vacation rental cabin. At the time, near the Grand Canyon, there were
14 listings on the first large vacation rental site, VRBO.com. With the advent of the internet and world wide web came the ability for the owner of a vacation property to list it online — and that was a HUGE change. Before that, if you had a vacation rental you marketed it by letting travel agents know, and by posting signs and maybe newspaper ads. But the internet changed everything in that market as in so many others. While VRBO was one of the first and the biggest site at the time, many more would appear as internet access became ubiquitous and speedy. A group of smart investors started HomeAway.com, which purchased VRBO, and several other listing sites. Flipkey started up, then was snapped up by TripAdvisor. And Airbnb, now the 800 lb gorilla of the vacation rental market is a household name all over the world. In our area, there are now 1400 vacation rental properties, a 100-fold increase, but with changes in demand, the inventory is still constrained.

Surge in Supply and Demand

With the changes making access to vacation rentals easier came expanded marketing efforts by the listing sites and by individual owners. The market for vacation rentals has surged. It’s become so big that hotel marketing websites are almost all carrying vacation rental listings alongside their hotel listings. Most travelers now consider vacation rentals a viable alternative to hotels, and a large and growing segment of travelers prefer vacation rentals when they travel. During the last real estate bust, a large number of vacation homes suddenly became unaffordable for their owners. A large number of those owners chose to try renting the homes out rather than lose them to the bank. Some investors even decided to buy up houses during the downturn and re-purpose them as vacation rentals.

So the original seasoned and experienced vacation rental operators, mostly single home operations, suddenly came face to face with large numbers of newly christened owners and their rentals in the market. There was a bloodbath of sorts.
So many stories of people failing at renting out their homes, despite obviously huge demand and easy listings. What’s the real story behind it all? The hastily fielded vacation homes were not designed to be vacation rentals and they weren’t run by experienced vacation rental professionals. Two categories of vacation rentals emerged. There are a lot of vacation rentals in the market which are cheap to rent but don’t offer a good experience for the traveler. So, they don’t get rented as often as their owners’ hope. On the other hand, there are professionally managed vacation rentals that have much higher occupancy and offer a much better travel experience but that have higher nightly rates. As with any product category, there are widely varying degrees of quality to be found.

**Investment Returns**

For an investor looking for passive returns in real estate, ownership in professionally managed rentals are what you should consider investing in. While the AVERAGE return on vacation rentals is just slightly higher than the average return on single-family rentals, the returns available from well-run vacation rental operators are above market. The average single-family rental home gross rental yields (gross rents/sales price) returns around 9%. That’s gross, not net. You might expect a secured investment in a vacation rental to
return 7-14%, NET, before appreciation, depending on whether you wanted regular and predictable cash returns or were willing to simply participate in the profits on a quarterly basis including seasonal swings.

How to Look for Passive Investment Opportunities

When looking for an investment opportunity in vacation rentals, here are some things to keep in mind:

- Look for operators who have an established business, with a track record of success.
- They ought to have properties which enjoy higher occupancy rates and higher nightly rates than superficially similar properties.
- Check out the properties they have now and see what kind of reviews they get.
- You are looking for operators who understand they are providing an experience for travelers.
- Talk to them, make sure they are trustworthy and will provide proper reporting to you on a quarterly basis.
- You should expect to be able to view the books on a property at any time. Look for an accounting of bookings and income, all expenses, bank statements, and a quarterly narrative comparing actual performance to plan with a discussion on the factors leading to variances.
- Vacation Rentals in all markets are seasonal, and even local event driven.
- Verify your investment is secured by an interest in the property.
- Look for quarterly premiums or profit sharing, and an annual allocation of depreciation for your taxes.
- Look for proper LLC Operating Agreements and Subscriptions Agreements that set out the terms clearly.
Customer Experience

Our own experience in the market over 14 years has validated our core tenets and shown up nicely in our bottom line. What you are actually selling isn’t necessarily the same as the merchandise. The more successful vacation rental operators understand they aren’t just providing a larger hotel room. Travelers who want to stay in a vacation rental are very much “experience” travelers. They want a place that looks great, like a magazine spread. They also want their stay to be a happy experience enhanced by the accommodations. Properties which cater to families and groups of friends need to provide awesome gathering spaces, pleasing views, and fully equipped kitchens, excellent bedding…the list goes on. And finally, the customer experience dealing with the operator is just as important. From initial inquiries, through booking, to thoughtful communications before during and after the stay, those experiences should make the guests feel listened-to and taken care of.

It is this understanding of what the customer really wants that makes the difference between extra successful operators which command higher occupancy and nightly rates and those that make up the bulk of cheaper and non-differentiated vacation rental properties. If you think investing in the hot vacation rental market is for you, now you know what to look for—the savvy operators with a superior product and a track record are looking for investors to grow their businesses faster.
Con: Tread Carefully, Every Deal is Unique

I’m not going to pretend I’m an expert in real estate, much less in the relatively small niche of vacation rental real estate. Katie and I travel a lot and have stayed in resorts, hotels, campgrounds, vacation homes through AirBNB and VRBO, cabins, and even wilderness areas. However, we have never invested in those properties and have little interest in landlord as a profession ever again. And if I don’t want to landlord, I certainly don’t want to run a hotel. So, all of our real estate investments are now passive by pretty much any definition of the word. In fact, we are even moving away from selecting the individual properties and notes we invest in to just hiring a professional to do that. It kind of reduces everything to a bit of a numbers game: How likely am I to get my money back, what am I likely to make on it, and how is that return going to be taxed. Beyond that, I really don’t care if I’m investing in single family homes, multi-family, commercial, storage, trailer parks, vacation homes, mortgages, or hard money loans. I really don’t. I just like mailbox money. But there are a few truisms about investing that I think are worth consideration when being pitched.

# 1 Stocks aren’t evil
Usually when someone wants to sell you something they point out the problems with investing in the stock market:

- Stocks are volatile,
- A large percentage of the return comes from price appreciation
- Company management can be corrupt
- You have little control over how the business is run
- People lost their retirement in 2008!
- More Gazillionaires got that way through real estate
- Whole Life Insurance provides guarantees

The list goes on and on. But after hearing this dozens of times, maybe you ought to consider why everyone compares themselves to the stock market. Maybe there is a reason it is the gold standard, especially for those looking for a passive investment return.

# 2 Some investments are more cyclical than others

When it comes to stocks, cyclical stocks are those which do well in economic booms when people have more money to spend. Just like stocks, some real estate assets are more cyclical than others. Guess which ones are the most cyclical? That’s right. Vacation homes. In a down market, guess what is the first thing you cut out to save money. Hint: it’s not rent and groceries.

# 3 Diversification and fees matter

Just because you move from one asset class to another doesn’t mean you should forget the basic principles of investing most learn with stocks—diversification matters. It protects you from what you don’t know. So if you haven’t sat down face to face and eaten a meal with those who are running a company or a property, it probably should not make up a very large percentage of your portfolio. If you have no influence over
how the business is run (and it’s pretty hard to consider it a passive investment if you don’t), then you should probably have more than one of them in your portfolio. Fees still matter. While managers can and often do provide additional value (particularly in less efficient asset classes), every dollar you pay them is still a dollar that comes out of your return.

# 4 Location, location, location

The most important factor in real estate is location. It always has been and always will be. I don’t care how fancy your property is or how well run it is if it isn’t close to where I want to be. Everyone else feels the same way.

# 5 Track record

While past performance is no guarantee of future performance, if you’re looking for a general partner or syndicator, a nice long, strong track record should be a requirement. How long is long enough? How strong is strong enough? It depends on the alternatives, but just like you don’t want to be in a teaching hospital on July 3rd, you probably don’t want to be an LP in someone’s first limited partnership.

Maybe vacation rentals are the hot new asset class in real estate. Maybe they aren’t. I have no idea. But tread carefully
and run the numbers because every deal is unique.

What do you think? Do you own a vacation rental individually or via a syndication? Why or why not? Do you think this is a good asset class to invest in? How much higher returns do you expect over apartment buildings during good times? How much worse in bad times? Comment below!

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Realtors and Physician Mortgage Loans with Peter Kim of Curbside Real Estate – Podcast #97

Podcast #97 Show Notes: Realtors and Physician Mortgage Loans with Peter Kim of Curbside Real Estate –

You work long hours. Your time is valuable.

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It is that time of year again where medical students and residents are itching to buy a home. Is it the right time for you? Hopefully, after listening to this interview with Dr. Peter Kim, founder of Curbside Real Estate, you will have a clear answer to that question. We address physician-specific issues encountered during the home buying process. We talk about how to avoid the most common mistakes doctors make when buying a home and how Curbside can save you time, money and stress. This is potentially the biggest purchase in your life, depending on how much money you borrowed to go to medical school. Buying the right house at the right time can really help you on the path to winning financially. And the reverse is true. Hopefully, this episode helps you make the best decision.

Sponsor

Stressed about Home Buying?

This episode is sponsored by Curbside Real Estate, a free real estate concierge service for physicians. The home buying process can be extremely confusing and difficult, especially for younger physicians. It can be tough to decide whether to rent or buy, know what your loan options are, and ultimately figure out what lenders and real estate agents you should
choose. After struggling through his first home purchase, Dr. Peter Kim founded Curbside Real Estate to address these physician-specific issues encountered during the home buying process. Curbside Real Estate is your physician-led “curbside consult” for physician home loans, expert real estate agents, relocation services, and everything in between. Whether you’re securing your first home loan, just beginning your search, or just not sure where to start, Curbside Real Estate can help you navigate the home buying process confidently and efficiently, saving you valuable time and money. Exclusive bonus for White Coat Investor readers: $100 bonus at closing. Contact Curbside Real Estate at hello@CurbsideRE.com or (650) 397-1728 for a no-commitment consultation.

Announcements

I made a couple of announcements at the beginning of this podcast episode so I thought I’d make note of them here. In case you missed it the White Coat Investor’s Financial Bootcamp book is out. Go check it out on Amazon. We are auditioning a producer currently for the audio book so that won’t be too far behind the print version. The book is dramatically more detailed than the financial boot camp emails, if you received those when you signed up for the White Coat Investor Newsletter.

We have dates for the WCIcon20. The Physician Wellness and Financial Literacy Conference. It’s going to be in Las Vegas, March 12th through 14th, 2020. A travel day on the 11th, with a reception that night, and a travel day on Sunday, the 15th. It will be at the Paris and Ballys in the Paris Conference rooms. You can’t register until July so don’t book a hotel room before then. There will be plenty of hotel rooms, but save the dates if you need to clear your clinical schedule for that.

If you want to speak at that, you can submit an application. If you just want to give input on who you want to hear from at
the conference, there’s also a separate little survey for you to give suggestions.

Quote of the Day

Our quote of the day today comes from Morgan Housel. He said,

“Singer Rihanna nearly went broke after overspending and sued her financial advisor. The advisor responded, ‘Was it really necessary to tell her that if you spend money on things, you will end up with the things and not the money?’”

It’s a good question. There are a lot of people out there who are very famous and have made a lot of money, but really don’t have much of it left. It is really unfortunate. It turns out that making money is not the same skill as keeping money.

Passive Income MD

I’m not sure all the listeners had figured out that Dr. Peter Kim is the man behind Passive Income MD, a member of the White Coat Investor Network, and the owner of Curbside Real Estate. He has been on the podcast a few times in both roles but because he was blogging anonymously for a while I’m not sure everyone connected those two.

Before we got into the interview about home buying I asked Peter what is new at Passive Income MD. He is working on a couple of upcoming courses, dedicated to helping people figure out the whole real estate investing thing. The first course is about investing in passive real estate investments, like syndications and funds.

I think some people will be really excited about that. A common question I get is, “How do I tell these apart? How do I decide what funds or what syndications or what crowd funder to go with? I don’t know the first thing in evaluating these.” It is just not as easy as going and buying a total stock market
Home Buying Process

Curbside Real Estate

I asked Peter to explain to readers what Curbside can do for them. The home buying process is confusing especially for first time buyers. It is a huge decision that can really set you off in a different direction financially. There are people that make this decision wisely and their financial futures end up well as a result, and there are other people who might make a pretty poor decision when it comes to buying a home, and then they find themselves in a little bit of trouble that they have to make up over the next couple of years. So Curbside helps you throughout that entire process, from deciding if it is a good time to buy a home, to finding a realtor, to getting the right loan. In this episode, we talk about all those aspects of the home buying process.

Timing for Buying A Home

In Peter’s experience, the biggest mistake people make in buying a home is buying too early, without going over their whole financial situation. Most people think about buying a home immediately when they graduate. He had someone who is in fellowship reach out to him recently. They are graduating pretty soon and started asking him about whether any of the physician loans will cover a two and a half million dollar home. This was Peter’s response,

“I know that you feel like you’ve been holding back, and there’s been some delayed gratification and you want to buy a home and you want to start your life, but this may not be the
So they talked through his financial issues like getting a hold of his debt and the fact that a lot of people don’t necessarily stay in that first job.

I asked whether that is a separate mistake from buying too much house or if those are tied together. He said,

“They usually go hand in hand. People want to buy soon and they want to buy big. And knowing their financial situation, knowing that they’re in a point of transition, knowing that possibly their family may be growing at that moment and their needs may change in a short amount of time, I mean, I think they all go hand-in-hand. Once you get a good hold of when to buy, then I think other decisions about what size house or price house to buy all kind of fall in line.”

People believe that buying a big home right away will be a key to happiness. It’s the whole American dream thing. But the key is really about buying it at the right time. This time of year we have lots of medical students and incoming residents reaching out to loan officers on our site with this burning desire to buy a home. Depending on the length of the residency and the cost of living in the location it might make sense to buy.

Every time I look at the numbers, it seems like at a five-year residency, it’s about a 50-50 proposition of whether you’re going to come out ahead renting or not, just from a financial perspective, not talking about the hassles of home ownership or anything like that. The shorter residencies it does work out maybe a third of a time, but that seems like a pretty big gamble to take, especially given the other hassles of buying and selling at such a busy time in life. So my general recommendation has usually been that the default ought to be renting during residency. But there’s no doubt that it does
work out for some people.

It’s almost like it is cyclical. You get a few years where housing values really go up quickly, and so people go, “Well, of course I have to buy in residency,” and they buy just in time for housing values to go down. And then the next group comes along three or four years later, and they go, “Well, housing values don’t always go up. I’m not buying.” And they miss out on a boom when they do go up. It’s almost like you can’t win here sometimes.

What you really need to do is just be in the house long enough that you’re in there that whole cycle. If you’re in there 7-10 years, you’re going go through a downturn, you’ll go through an upturn, and you’re probably come out ahead because you can spread those transaction costs out over all that time period, so appreciation can be greater than the transaction costs. In a two to four-year time period, it’s really a gamble whether you’re going to get the appreciation you need to overcome the transaction costs.

Another mistake is not looking at those costs of buying and maintaining a home. People fall into this idea that if your mortgage payment is less than your rent, you should buy. That is as deep as they go. They don’t stop to think, “Well, is there more to it than just the payment?” Because really, you can make that mortgage payment about anything you want by spreading the mortgage out as long as you can.

People think about the tax benefits but a lot of people don’t realize that they may not get those tax benefits. Most attendings do, because they’re itemizing, but a lot of residents, especially with the new higher standard deduction are not actually getting a tax benefit for buying.

### Buying a Home in a HCOL Area

Peter lives in a high cost of living area in California. I
asked him if there are special considerations there for docs as they buy homes.

He said that physician mortgage loans definitely come into play there. The three main features you will see with physician loans are:

1. No PMI despite a down payment of less than 20%.
2. Special treatment for the student loans (usually that they only take required payments into consideration)
3. Will close before you actually start working (i.e. accept a contract instead of pay stubs as evidence of future earnings)

Where a two bedroom-two bath home starts at a million dollars saving up 20% for a downpayment right out of residency just isn’t feasible. Lenders that specialize in this area, know how to manage your whole debt to income ratio and help you qualify for the loan that you’re looking for.

Another thing in these high cost of living areas is that your house is just a much bigger piece of your financial life, in terms of your net worth. In my case, my house is almost negligible. I mean, maybe it’s 5 or 10% of my net worth, but it’s not a big piece my financial life. But in California, Seattle, DC, New York City that is a different story. It is a huge part of your net worth. When you start looking at net worth, towards retirement, you should definitely exclude the price of your home, or the actual value of your home right now as it sits.

In these HCOL areas, you do see quite a bit of appreciation. For Peter, their home value has doubled, and that’s added seven figures plus to their net worth, but again, it doesn’t mean much unless they sell it. I was looking at statistics for California housing the other day, and if you look at the bottom of the mark, and I think it was 2008 in California, the Bay Area has more than recovered from that. It was well above
the 2008 level. But California on average has not. It still has not recovered 10-11 years later from the trough that it fell to in 2008. A lot of people just don’t realize that in these “can’t lose real estate areas” that you really can lose for quite a long period of time. I think they say in real estate that time heals all wounds, but it might be a lot more time than you think to get back to the value you bought something at if you end up buying at a peak.

Buying a Home as an Attending

For someone coming out of residency, how long should they wait to buy a home? It is definitely a point of transition. I think the statistics I’ve seen are that 50% of attendings change jobs in the first two or three years. That is a tough time to buy a home. Peter asks people,

“‘Are you willing to just wait until you know that you’re a little bit more settled, that you like the job, that you want to stay there, that your family isn’t growing, and these kind of things?’ It’s a crazy point of transition that people have no idea until they get there. I suggest to people, that if you can hold it off for a couple of years, you’re probably better off. I mean, especially if you’re a 1099, you’re actually going to really have a hard time getting a loan without at least one or two years of tax records of you working at that similar job.”

I’ve always told people, 6 to 12 months. My theory behind that is that you want to make sure that your professional life is stable. I think you need some time to find out whether you like the job and whether the job likes you, and I think that takes six months. It is hard to get a rental contract for six months though. Usually, you have to sign for a year, and so that’s why I go 6 to 12 months. At that point, most people have a pretty good idea whether that job is going to work out. There are always going to be surprises but you have to weigh
that against waiting to buy, because as you know, the longer you’re in someplace, the better deal it is to buy. And if you wait too long on the front-end, that just shortens the period of time you’re in the home.

I think it is a little bit of a balancing act. But this idea that you should buy four months before your residency ends, I think is where you often run into these people that just feel like they’re in these golden handcuffs. The hospital administrator that employs them has got them exactly where they want them. They have this big, fat mortgage. If they sell and move to another job, they’re going lose $100,000 or $200,000 because of that house. I think you have to be careful not to get locked into that kind of a position.

Peter said Curbside was created to help people get into homes, but often times he ends up talking people out of buying right then. He wants to help people get into the right house at the right time.

Financial Tasks to Take Care of Before Buying a Home

Remember that doctor who asked Peter if he could get a physician loan for 2.5 million? Well, he also had $3-400,000 in student loan debt with a high interest rate. While neither
Peter nor I push for all your student loans to be paid off before buying a home, we both think you at least need to have a plan for it. If refinancing is the right choice for you because you have a high interest rate and are not going for PSLF than refinance your loans. Some people don’t want to refinance before getting a mortgage because that is going to ding their credit score then they will get a lousy interest rate on the mortgage but after taking a credit score course last year, Peter thinks that idea is overrated.

What has the most impact on your credit score is obviously defaults, foreclosures, and being late on payments. But one of the other big things is really your credit utilization. Peter suggests, “If people can be smart about what gets reported on a monthly basis to these credit agencies, for example, by either paying off their credit cards a little bit early so it doesn’t get reported there, these kinds of things have far more impact on your credit score than a couple checks on it. By refinancing your loans, number one, it really won’t impact your credit score significantly by a couple of those credit score pulls, but what it will help you in the debt to income ratio, that can help you actually get the mortgage that you need.”

So make a plan for those student loans and take action on that plan before buying a home.

**Realtors**

A big part of Curbside is connecting doctors with realtors. So I asked Peter what he thinks about realtors? What value does he see them adding? Does he think they’re worth using for buying, selling, both? And what he thinks about that classic 6% commission structure?
He actually has his real estate broker’s license. He got it so he can understand that market. He doesn’t go out and buy or sell homes but wanted to learn a little bit more about the industry, what they do and what value they bring.

Now he thinks they can bring a significant amount of value. A lot of it deals with regulations and making sure disclosures and disclaimers in the contract are done correctly. And then being able to negotiate some things he didn’t even know you can negotiate. It really has to do with the realtor and their knowledge. When he buys some investment properties, he still uses realtors. He thinks they have a better understanding of the market. They know what things can be negotiated. And sometimes it’s easier for him to negotiate through a third-party. Having another set of eyes on that contract, taking a look at that, understanding that local market, adds a lot of value, especially on this type of purchase that you hope to be in for 5-10 years and is probably the biggest purchase of your life.

But Pete certainly understands there are people who have been through this process before. They understand it. They know how to read that contract. They understand the ins and outs of what they can ask for, what they negotiate, and they feel comfortable with it. If that’s the case, they could go directly to the seller, or go to the seller’s agent and try to negotiate maybe something else additional off by not bringing a realtor to the table. If you’re comfortable with it, do it.

Curbside helps a lot of people that happen just to be buying in a different state. They’re relocating for whatever reason. They are moving to that area, and they don’t know anyone. So sometimes they need someone on the ground to kind of help them through that process.

Now selling a home with a realtor can be a heated discussion. Is it worth saving that two and a half to 3% to not have representation? Again, that’s a personal decision. If you feel
comfortable with the process enough to make sure that everything on the contract is done, all of the disclosures are done correctly, and that if something gets in a little bit of a hairy situation that you can handle it, then that’s fine. Go for it. These days there are resources online like For Sale By Owner, FSBO, is a good site where they help owners ultimately sell their own homes without representation. There are even some contracts there that you can look at.

The industry is changing. I think a lot of the criticism comes because, like asset under management fees for financial advisors, all of a sudden, the guy with the two million-dollar California house is paying four times as much as the guy with the 500,000-dollar Utah house. Same house. Same amount of work to sell it, and yet in California, you pay four times as much for it. I think that’s probably what is driving a lot of these disrupting companies that are trying to disrupt the industry in this space. They’re saying, “That’s a lot of money to pay 5 or 6% of a two million-dollar house.” Will these companies trying to disrupt the industry have success in the long run?

Peter has asked realtors that and they are pretty confident that they’ll still be doing business. It is a relationship business. People like people guiding them through these type of things and know that there are a lot of nuances to every transaction. He think there will be a subset of people that will prefer some of these online platforms but a lot of people will still want that personal care to make sure everything gets done correctly.

One of thing Peter mentioned is that people do worry about the incentives.

“People don’t like the fact that they feel like agents are just incentivized to get the deal done. I think that’s something important to address. That can truly be the case. I mean, they have a commission sitting there waiting for them
as they represent you if that transaction gets done. So maybe they want to push that transaction and get it done. I think that’s the concern with just choosing whatever agent that you want to choose. And I think it really helps to make sure that you understand who that agent is, what their history is, and what kind of relationship that they’re looking for.”

I’ve often wondered if it would be more interesting to structure the commission as rather than just percentage of the entire deal, a higher percentage of the amount over a certain amount to really incentivize them to sell it for as much as they can. I don’t know that I’ve ever actually seen a contract structured that way, but the more I think about it, the more that’s how I think maybe it should be structured. I think there’s a lot of inertia in the industry that’s keeping it from happening. I guess I wouldn’t be surprised 10 years from now if we’re doing this particular business very differently.

**Physician Mortgage Loans**

When is it a good idea to use a physician loan versus using a conventional mortgage?

If you have the option, there are a couple things that you have to consider. Compare the loans. Each bank that you work with, if they’re offering you a physician loan, they can offer you a conventional loan. So see what those interest rates are and you can do a little bit of a calculation to see what might make sense. Part of the question is if you had that option, would you do 20% or would you put down 10%? What would you do with that difference in the down payment? It might make more sense to take that money and invest it elsewhere. Now, I’ve never bought with a physician loan. Our last two purchases were with a conventional loan, and we had a down payment, but I was also able to max out all of my retirement
accounts. I didn’t have any other student loans or any other kind of even moderate interest debt to pay off, and so it seemed like a good use to us of that money. But I think someone that’s got a bunch of 7% student loans and it’s otherwise the right time for them to buy a house for personal and professional stability reasons, I think it’s okay to use that money on the student loans rather than the down payment, and use a doctor loan.

What mistakes have you seen doctors make when financing a home?

“The number one thing when people look for financing a home, when they look for a physician home loan, is they just go after whoever dangles the best rate in front of them. They go out, and everyone is use to using these comparison sites, and so they want to do the exact same thing for physician home loans, and they just go for the one that dangles the lowest rate in front of them.

“Unfortunately, what happens is that nobody can guarantee you those loans, at least that rate, until you’re actually in escrow on the property. What that means is that your offer has been accepted, the contract has been signed, and then you can go back to that same lender and lock in a rate. Now, what people tend to find is that when you go to lock in that rate, it’s not necessarily a loan that they initially told you that you would get. The market changes. I think people chase the lowest rate and they don’t necessarily think about the service that they’re going to get.”

When it comes to closing that loan, on deadlines getting closer, even though the bank promised a certain rate they can’t deliver on it. People feel like they got maybe a little bit of a bait and switch. People just get tricked into certain lenders because of the rate that’s dangled in front of them. It is important to understand the ability for that lender to
close, what their track record is, and who you’re working with at that particular bank. It does matter. You can go to the same bank and try to get a loan there, and it does matter who the loan officer is. Depending on how they package you, how they counsel you from the beginning, some of them will know from the very beginning that you will not really qualify for this loan at their bank, so it’s not even worth trying. We have a recommended list of loan officers that have years of experience with physician mortgage loans.

Ending

I hope you found this discussion with Peter helpful. I know with match day this week and residencies ending in a few months many of you are thinking about buying a home. Reach out to Peter at Curbside for any help you may need in this process. And think about what was discussed today before buying that house. Make sure it is the right house at the right time.

Full Transcription

Intro: This is the White Coat Investor Podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high income professionals stop doing dumb things with their money since 2011. Here’s your host, Dr. Jim Dahle.

WCI: Welcome to White Coat Investor Podcast episode number 97, Realtors and Physician Mortgage Loans with Peter Kim. This episode is sponsored by Curbside Real Estate, a free real estate concierge service for physicians. The home buying process can be extremely confusing and difficult, especially for younger physicians. It can be tough to decide whether to rent or buy, know what your loan options are and ultimately figure out what lenders and real estate agents you should
choose.

WCI: After struggling through his first home purchase, Dr. Peter Kim founded Curbside Real Estate to address these physician-specific issues encountered during the home-buying process. Curbside Real Estate is your physician-led Curbside consult for physician home loans, expert real estate agents, relocation services and everything in between. Whether you’re securing your first home loan, just beginning your search, or just not sure where to start, Curbside Real Estate can help you navigate the home buying process confidently and efficiently, saving you valuable time and money.

WCI: There’s an exclusive bonus for White Coat Investor readers. You get a $100 bonus at closing if you go through the links in the podcast notes today. Contact Curbside Real Estate at hello@curbsidere.com or call 650-397-1728 for a no-commitment consultation. Thanks so much for what you do. I know your daily work is not easy. It took a long time to learn how to do what you do. And it’s really high liability work. So thank you for taking the time and the effort and going in every day and taking care of patients that really do need your help.

WCI: A couple of announcements to make early on the podcast, the White Coat Investor book, the second one, the White Coat Investor’s financial Bootcamp is out. So be sure to take a look on Amazon for that. You can get that now. There should be … probably about the time you hear this, it’ll be available as an e-book as well as an audiobook. So look for that. We’re very proud of that. We’ve been working on it for a long time. And it’s dramatically more detailed than the financial boot camp emails, if you receive those when you signed up for the White Coat Investor Newsletter.

WCI: Also, it’s a good time to save the date for WCI Con 20. That’s the Physician Wellness and Financial Literacy Conference. It’s going to be in Las Vegas, March 12th through
14th, 2020. With the travel day on the 11th, we’ll have a reception that night, if you can get there in time for that, and a travel day on Sunday, the 15th. But that’s gonna be pretty awesome. It’s gonna be at Paris and Ballys in the Paris Conference rooms. You can’t register until July. I wouldn’t bother booking a hotel room before then. There’s going to be plenty of hotel rooms, but it’s a good time to save the dates if you need to clear your clinical schedule for that.

WCI: We’re very excited. We’re taking speakers for that now. If you want to speak at that, you can submit an application. You can find that on the website, and we’ll put a link to that in the podcast notes as well. If you just want to give input on who you want to hear from, there’s also a separate little survey you can do that you can give suggestions for who you’d like to hear from at the conference.

WCI: Our quote of the day today comes from Morgan Housel. He said, “Singer Rihanna nearly went broke after overspending and sued financial advisor. The advisor responded, ‘Was it really necessary to tell her that if you spend money on things, you will end up with the things and not the money?’” It’s kind of a good question. You know, there’s a lot of people out there who are very famous and have made a lot of money, but really don’t have much of it left. It’s really unfortunate, but it turns out that making money is not the same skill as keeping money.

WCI: All right. We have a special guest today on the podcast. It should be well known to people who’ve listened to all the other podcast. We have Peter Kim here again with us. Peter is an anesthesiologist and a serial entrepreneur. He’s the man behind Passive Income MD, a member of the White Coat Investor Network, and the owner of Curbside Real Estate, the sponsor of this episode, and he’s a good friend. He’s actually coming out to Utah three days with this family. We were just making arrangements to meet for lunch before he heads up to Park City to do some skiing. And so I’m looking forward to seeing him
then. Of course, by the time you hear this, that lunch date will have been well in the past. But welcome to the show, Peter.

Dr. Kim: Hey, thanks for having me. I’m really excited to be here.

WCI: Now, you’ve been on the show several times before, but I’m not sure all the readers ever really connected those two businesses unless they’re really good at recognizing your voice. I guess that was because you were blogging anonymously at the time. How’s it feel to be out of the anonymous blogger closet?

Dr. Kim: You know when I made that decision, or actually leading up to the decision, there was a lot of fear there. I mean, putting yourself out there especially online, privacy issues, things with your work, I mean, there were a lot of concerns. So it did take me a couple of months to make that decision. But then once I made that decision and I … I’ll be honest with you, my finger was kind of hovering over that whole submit when I wanted to just publish the post, but not much happened. You know, people at work didn’t start telling me things or having issues with my blog. In fact, kind of the opposite. Some people started … Some people did read it. They reached out to me. They started sharing their issues, started sharing their concerns. And we talked about how we could kind of help each other.

Dr. Kim: And it’s similarly, on the blog, on our Facebook group, I mean, it gave me the opportunity to really get out there and do what I love, which is interact with people. And yeah, to really build a community as a result. And so really, it’s only been positive things.

WCI: So tell us a little bit about what’s new with Passive Income MD. Anything that listeners can look forward to there?

Dr. Kim: Well I’m kind of following your lead a bit. Always
try to grow the brand and kind of really improve what resources we have for physicians who are looking for multiple streams of income, and in particular when it comes to real estate. So one of the newest developments is ... I think I can tell people this now, is we have a couple of upcoming courses, a couple of things that are really dedicated to helping people ... like a whole package, from start to figuring out, okay is real estate something that makes sense for me? And then ultimately, how do I ultimately get to the point where I can invest in real estate, understand the whole process?

Dr. Kim: In particular, the first course that’s going to be coming out here is about investing in passive real estate investment. It’s like syndications and funds. So it’s going to ... it takes a few months for these things to really kind of come to completion, but I think you’ll see it come down the pipeline pretty soon.

WCI: Yeah. I think people will be really excited about that. That is a common question I get is, “How do I tell these apart? How do I decide what funds or what syndications or what crowd funder to go with? I don’t know the first thing in evaluating these.” It’s just not as easy as going and buying a total stock market index fund where you just buy it all and forget about it. You know, it’s much more complex than that, unfortunately.

WCI: All right. Let’s turn to Curbside a little bit. Can you explain to readers what Curbside can do for them?

Dr. Kim: Sure. I think you mentioned it a little bit in your intro, but I mean this home-buying process is, it’s confusing. I mean, it’s difficult, especially your first one. But every time you do it, I mean, it’s never quite simple or kind of smooth or these kind of things, especially for young physicians. I mean, you come out of residency, you come out of fellowship, and one of the first kind of like rites of passage or things that you feel like you want to do as you get settled
is to buy a home.

Dr. Kim: The problem is nobody kind of teaches you how to do it. And you know, navigating the whole loan process, finding what loans might work, even just trying to figure out whether it’s actually a good time to buy or not … you know, the whole rent versus buy scenario … I mean, that’s a difficult decision. And it’s a huge decision that can really kind of set you off in a different direction in terms financially. I mean, there are people that make this decision wisely and their financial futures end up well as a result, and there’s other people that do the other way. I mean, they might make a pretty poor decision when it comes to buying a home, and then they kind of find themselves in a little bit of trouble that they have to make up over the next couple of years.

Dr. Kim: So we help them throughout that entire process. I mean, as you mentioned, I had a really, really rough go at it when I came out of fellowship. My wife is also a physician. So we were both in that same boat. We came out. We wanted to find a home. And it was just a painful process, especially figuring out what loans to kind of work with, and then what realtor to work with. So it took me a lot of time, energy and effort while I was still trying to find my way at work to figure all this stuff out. And luckily once I did figure it out, I started just telling people about it, mostly my colleagues, actually my former resident … my resident-mates, and I started setting, “Look, I’m just gonna make it easy for you, I just went through it and you know, if you have any questions about it, just reach out to me.”

Dr. Kim: And so they started doing that. And the next thing you know, they’re saying, “Hey, you mind if I tell … my friend calls you because they also have some questions and I can’t really explain as well as you do?” So it just started growing organically, and that’s when I kinda figured out, “All right, there’s really no help out there for physicians in this kind of arena,” and that’s when, essentially, Curbside was created.
WCI: So let’s break that down a little bit. You went through a lot of different things that people have to go through when they’re getting a home. Let’s talk just about buying a home for a minute, you know, not so much about the realtor, not so much about the loan. What are the big mistakes that people make when they’re buying a home?

Dr. Kim: I think one of the biggest ones is buying a home possibly too early. I think most people think about buying a home immediately when they graduate. That’s the first thing they think of. The reason I know this is that I’ll tell you for example, someone I know who is in fellowship just reached out to me. They’re graduating pretty soon in a few months here, and they started asking me about whether any of these physician loans will cover a two and a half million dollar home. I said, “Whoa. Whoa. Whoa. Slow down. Let’s get on the phone here.”

Dr. Kim: And I started going over a few things. I said, “I know that you feel like you’ve been holding back, and there’s been some delayed gratification and you want to buy a home and you want to start your life, but this may not be the best time depending on what else you have going on.” So we kind of talked through his financial issues.

Dr. Kim: So, yeah, I think people don’t think about the other financials that you talk about, I mean, really getting a hold of debt, understanding where you are financially. This is a kind of a time to transition, let’s be honest here. First couple years out, I don’t know what the percentages are, but I mean, I tend to find that a lot of people don’t necessarily stay in that first job. So I think buying too soon without going over that whole financial situation is probably the biggest mistake that people make.

WCI: Do you think that that’s a separate mistake from buying too much house, or do you think they’re tied in together somehow?
Dr. Kim: I mean, they usually go hand in hand. People want to buy soon and they want to buy big. And knowing their financial situation, knowing that they’re in a point of transition, knowing that possibly their family may be growing at that moment and their needs may change in a short amount of time, I mean, I think they all go hand-in-hand. Once you get a good hold of that, then I think those decisions, other decisions about when to buy, what size house or price house to buy all kind of fall in line.

WCI: Now, what is it about us? So why do we think that buying a house right away, and buying a big house is going to make us happy? Where does that come from?

Dr. Kim: I mean, it’s called the American dream, I guess, for a reason, or maybe that’s how it’s marketed. I mean, I still think ... I mean, I’ll be honest with you, I did ... we got into our home pretty early, and we still live in that same house today. I think it’s about seven years now.

WCI: So worked out for you.

Dr. Kim: It worked out really well. And it did. And when I look back at it, we were in the middle of a ... I’m gonna say 2012. So, basically coming out of that big recession. And so the price point that we bought at, to be honest with you, I don’t think we could afford today. So it did work out for us, but I think that it went through ... we went through a lot of the whole thought process about whether it made sense for us, and we didn’t just dive into it headfirst, and luckily it all worked out. We kind of lined things up so that probability-wise, the chance of success would be a lot better. But, yeah, I don’t know. Physicians, I mean, it’s the same thing with the car phenomenon. I mean, you want to buy a big car ... I mean, a nice car when you come out. And I think unfortunately, the cars have a lot smaller price point than a home is. But, yeah, I mean, people just are sold that this will be kind of one of the keys to happiness. And I don’t think that necessarily is
the case.

WCI: So lots of graduating medical students, incoming residents, and especially their partners seem to have this burning desire to buy a home. Why do you think that is? And do you think it’s a good move to buy during residency?

Dr. Kim: Well, it’s the whole point of feeling like you’re putting down roots. Now, depending on your residency and the length of term of the residency, and the location that you’re buying, the cost of living there, doing like a rent versus buy analysis, it might make sense. I’ve seen it work out for some people, I mean, especially in some of these longer residencies, I have friends who are doing some of these five and seven-year type residencies and they can kind of ride through whatever the economy happens to do at that time. And I know many situations where it’s actually worked out really well for them. I mean, some of them even kept that place afterwards and then renting it out just because it happens to be in a very, very nice area for renting, especially if it’s near a medical center and that sort of thing.

Dr. Kim: So it can be. I think people just … they’re in school so long. I mean, you’re in college. You’re in medical school. Maybe they took off a few years, did some research, did a few other things. I think just that feeling of kind of being settled and moving on with your life. And as you see your other friends who didn’t go into medicine, reaching that stage where they’re starting families, buying homes, and these kind of things. And so you feel like why not? Why not me?

WCI: Yeah. Every time I look at the numbers, I look at it and it seems like at a five-year-period, a five-year residency, you’re general surgery or something, it’s about a 50-50 proposition of whether you’re going to come out ahead renting or not, just from a financial perspective, not talking about the hassles of home ownership or anything like that. And you get shorter residencies, you know, a peds or an emergency
medicine three-year residency and, boy, I don’t know, it does work out maybe a third of a time, but that seems like a pretty big gamble to take, especially given the other hassles of buying and selling at such a busy time in life.

WCI: So my general recommendation has usually been that the default ought to be renting during residency. But there’s no doubt that it does work out for some people. It’s almost like it’s cyclical though, right? You get a few years where housing values really go up really quickly, and so people go, “Well, of course I gotta buy in residency,” and they buy just in time for housing values to go down. And then the next group comes along three or four years later, and they go, “Well, housing values don’t always go up. I’m not buying.” And they miss out on a boom when they do go up. It’s almost like you can’t win here sometimes, I think.

Dr. Kim: Right. What did you end up doing?

WCI: I ended up buying during med school, which was a mistake, and renting during residency, which was a mistake. So I lost out on both ends, you know? The one we bought in med school, we bought for 80,000, we sold it for 83,000, right? And the problem is people are like, “Oh, you made money.” No, we didn’t make money. It’s not that simple. Just selling it for more than you bought it for doesn’t mean you made money. You got to subtract out the transaction costs and all the other costs of home ownership. We lost thousands.

WCI: Then in residency, I was in Arizona from 2003 to 2006, right? I mean, things doubled over that three-year time period. Obviously, you couldn’t have planned for that. If you had a working crystal ball, it would’ve worked out well. So obviously that period of time, we would’ve been better off buying. So then we come out of residency, we go to Virginia, and we decide, “Oh, we’ll buy, you know.” You know how everything ended up. Anybody that bought in 2006, there it was in 2015 selling it for a loss, you know.
WCI: So it’s almost like you kind of get this cyclical nature to it that works poorly against you, which is unfortunate. And what you really need to do is just be in the house long enough that you’re in there that whole cycle. You know, if you’re in there 7, 8, 10 years, you’re gonna go through a downturn, you’ll go through an upturn, and you’re probably come out ahead because you can spread those transaction costs out over all that time period. So appreciation can be greater than the transaction costs, but in a two or three or four-year time period, it’s really a gamble whether you’re going to get the appreciation you need to overcome the transaction costs.

WCI: The other thing that really, I think, people fall into is this whole idea that if your mortgage payment is less than your rent, you should buy. And that’s as deep as they go. It’s just that superficial, you know? They don’t stop to think, “Well, is there more to it than just the payment?” Because really, you can make that mortgage payment about anything you want by spreading the mortgage out as long as you can. So I think people make that mistake a lot too.

Dr. Kim: Yeah, I think taxes comes up a lot too. I mean, when people start talking about it, they think of the tax benefits. I mean there are definitely some tax benefits there, but people also forget just the other costs of home ownership. I mean, I find that any time anything breaks, that normally you will call a landlord for, next thing you know, it’s over a thousand dollars that you’re paying out. And yes, that goes into some things you can write off ultimately there, but there’s an additional cost there that people don’t necessarily consider.

WCI: Yeah, for sure. It’s pretty interesting too. A lot of people don’t realize, they may not get those tax benefits. Most attendings do, because they’re itemizing and they’re paying enough, and property tax or charitable contributions, and their income taxes and the mortgage interest that it works out, but a lot of residents, especially with the new higher
standard deduction, they’re not actually getting a tax benefit for buying, you know, unless you actually run the numbers and know what your tax situation is. That’s I think heavily oversold by the industry as well.

Dr. Kim: Right.

WCI: Let’s talk for a minute about high cost of living areas. I mean, you live in California, right? Are there special considerations there for docs as they buy homes?

Dr. Kim: Well, the lower down payment, these physician loans where you’re able to pay a lower down payment without the private mortgage insurance or PMI as it’s otherwise called, definitely come into play a lot more here. I mean, we’re looking at homes where homes start at a million dollars for a two-bedroom, two-bath home. So that may sound normal for some of these people up in the Bay Area, they might think that’s cheap, but for I think a lot of the people that are listening to this, I’m guessing that probably feels a little bit expensive.

Dr. Kim: So physician loans definitely come into play here a lot greater and knowing what those loan limits are really important, and there are a few lenders that, depending on what that price point is, they really are … they’re specialized in this, in kind of dealing with how to manage your whole debt to income ratio, and kind of ultimately help you qualify for the loan that you’re looking for. So I think that you can’t just blanket or go to anybody out there. There are special ones and especially in certain states which you have to go to that kind of understand how this process works.

WCI: Now, I mean, the other thing that it seems like in those high cost of living areas is that your house is just a much bigger piece of your financial life, you know what I’m saying?

Dr. Kim: In terms of your net worth, you mean?
WCI: In terms of your net worth, in terms of what you have to be thinking about, you know? I mean, in my case, my house is almost negligible, right? I mean, maybe it’s 5 or 10% of my net worth, but it’s not a big piece my financial life. It’s like a quote I’d put in the financial boot camp book, that basically if you have to ask how much a house costs, you’re buying too much, you know? But in California, that’s not an option, in Seattle, in DC, in New York City, you know? I mean, it’s gonna be this huge figure that you look at and you go gulp, whereas if you’re buying in Indianapolis, you probably took out a bigger loan to pay for medical school than you did to buy your house.

Dr. Kim: I mean, that to me sounds pretty crazy. You’re right. I mean, that is the, by far, especially where I live, Bay Area, that dictates everything. And it’s kind of funny to see we’re at a time right now where I see a lot of physicians coming out. They can’t even afford anything around some of the hospitals here. They have to drive and find places that are hour, hour and a half away, especially here in LA.

WCI: That sounds incredibly dangerous as a resident.

Dr. Kim: Yeah. It’s a far drive. And unfortunately, that’s what the cost of living here is like. I mean, it seems unsustainable. And in terms of your net worth, it’s a huge part of your net worth. And when you go start looking at net worth, towards retirement and these kind of things, you should definitely ... I mean, I tell people definitely exclude the price of your home, or the actual value of your home right now as it sits, but it’s a huge part. But the thing is, we do experience, especially in some of these areas, a good amount of appreciation. Now, I know that doesn’t mean much, but it could mean something if you decide to ultimately move somewhere else. I mean, that’s what you have to make the decision, or downsize a bit.

Dr. Kim: Our home here, again, we were really lucky to buy
when we did. I mean, there are again, certain situations, and I can’t say we totally knew that that would be the case, but I mean our home price is over doubled, and that’s added seven figures plus to our, “net worth”, but again, it doesn’t mean much unless we do something with it.

WCI: Yeah. It’s interesting. I was looking at statistics for California housing the other day, and if you look at the bottom of the mark, and I think it was 2008 in California, I can’t remember exactly when it was, the Bay Area has more than recovered from that. It was well above the 2008 level. But California on average was not. It still has not recovered 10, 11 years later from the trough that it fell to in 2008. And a lot of people just don’t realize that in these can’t lose real estate areas, that you really can lose for quite a long period of time. I think they say in real estate that time heals all wounds, but it might be a lot more time than you think to get back to the value you bought something out if you end up buying at a peak.

Dr. Kim: Yeah. I mean, that’s unfortunately the case, but again, there are other kind of … there are for certain people in certain situations that tax benefits are there as well too. So I think this whole … and then, of course, the emotional aspects of being in a home, being settled with your family, being at a certain school district and that sort of thing. So there are other factors, it’s just kind of you have to kind of look at the whole picture and not just look at the numbers.

WCI: Okay. So we talked about residents. We talked about high cost of living areas. Let’s talk for a minute about attendings, okay? Someone’s coming out of residency. How long should they wait to buy their home, or should they wait?

Dr. Kim: Again, it really depends on their situation. I think that’s definitely a point of transition. Their first job … You know, I don’t know. Do you know numbers that are attached to this kind of thing? Or how many people or what percentage of
attendings actually stay at their first job?

WCI: I think the statistics I’ve seen are that 50% change jobs in the first two or three years, I think is what I’ve seen.

Dr. Kim: That’s not surprising to me at all. So for me, that’s a tough time to buy a home, to be honest with you, just because you may move locations. You may move states. I mean, that happens quite a bit, and the next thing you know, you’re scrambling to get rid of that home. You know, we have that discussion with people all the time. What I always ask people is, “Are you willing to just wait until you know that you’re a little bit more settled, that you like the job, that you want to stay there, that your family isn’t growing, and these kind of things?” It’s a crazy point of transition that people have no idea until they get there.

Dr. Kim: So I suggest that people, you know, if you can hold it off for a couple of years, you’re probably better off. I mean, especially if you’re a 1099, like a lot of ER, people like yourself or a lot of anesthesiologist, you’re actually gonna really have a hard time getting a loan anyways, without at least one or two years of tax records, tax reports, of you working at that similar job anyways. So it’s a tough time. So a lot of times, I suggest people wait a little bit.

WCI: You know, I’ve kind of always told people, 6 to 12 months. And I think my theory behind that is that you want to make sure that you’re … both your personal life, if you’re about to get married or something, that’s probably not the time to be buying, or if you’re about to have a bunch of kids or something, that might not be the time to be buying just because you’re gonna end up buying some place too small for what you really need in the long run, but also your professional life is stable. I think you need some time to find out whether you like the job and whether the job likes you, and I think that takes six months.
WCI: It’s hard to get a rental contract for six months though. Usually, you have to sign for a year, and so that’s why I go 6 to 12 months, but at that point, I think most people have a pretty good idea whether that job’s gonna work out. I mean, there’ll always be surprises, but you gotta weigh that against waiting to buy, because as you know, the longer you’re in someplace, the better deal it is to buy. And if you wait too long on the front-end, that just shortens the period of time you’re in the home.

WCI: So I think it’s a little bit of a balancing act, but this idea that you should buy four months before your residency ends, I think is where you often run into these people that just feel like they’re in these golden handcuffs, right? The hospital administrator that employs them has got them exactly where they want them. They got this big, fat mortgage. If they sell and move to another job, they’re gonna lose 100,000 or $200,000 because of that house. So I think you got to be careful not to get locked into that kind of a position.

Dr. Kim: Yeah. I mean, it’s kind of funny. Even though this business … and this business was created to help people get into homes, often times I end up … I mean, I’ll be honest with you, sometimes I end up talking people out of it. I mean, it’s … the whole point is that I want to help people get into the home at the right time that makes sense for them and not put them in a bad situation. And I think waiting, like you mentioned, at least a little bit till they know what’s going on makes a lot of sense.

WCI: Yeah, right time, right home, exactly.

Dr. Kim: Yeah.

WCI: Okay. So any financial tasks that you think someone needs to do before buying a home? Is there something that they shouldn’t buy a home if they haven’t done this? Or do you think there are some things that need to be taken care of
first, or not really?

Dr. Kim: Well, I think dealing ... for most people, dealing with their student loan debt, and whatever debts might be out there is probably ... takes a little bit of priority over getting a home. To kind of go back to the person I mentioned before. He had a significant amount of student loan debt. I mean, he’s talking 3, $400,000 and talking about purchasing a home that’s in the well into the $2 million. So I think we kind of said, “Hey,

WCI: I’m just curious what income that doc had.

Dr. Kim: Well, I think there was a possibility for some family help for the down payment and that sort of thing.

WCI: But it’s just a typical doctor income, 2 or 3 or $400,000?

Dr. Kim: Yeah, yeah, pretty much typical income here in Los Angeles. But I said, “Look, if you had the opportunity and some family’s willing to help you with the down payment, and you’ve got these high interest loans at significant amount, you may be better off financially getting rid of those student loans first before you kind of throw that into a home, because once that debt is taken care of, you’re gonna find that you can save up pretty quickly actually for that home if that’s what you’re ... all those debts are taken care of.”

WCI: Now, when you say taken care of, you mean paid off. Are you suggesting people should pay off their student loans before buying a house?

Dr. Kim: Well, no, not necessarily, but he had this ... Well, his interest rate was quite high. His interest rate was quite high, so I said, “Why don’t you figure out if you can refi these loans, figure out what percentage you can get there, but just the whole point is to address those debt, that loans for ...”
WCI: To have a plan for it.

Dr. Kim: To have a plan for it. Doesn’t mean you …

WCI: Now, what about those who say, “Well, I don’t want to refinance before getting a mortgage because that’s going to ding my credit score, and then I’m going to get a lousy interest rate on the mortgage.”

Dr. Kim: Yeah, I think that’s overrated. I think the credit score, people are very, very afraid to have their credit even checked once or twice before they actually need something because they think their credit score takes a hit.

Dr. Kim: Now, I actually took a credit score course sometime last year, because I really wanted to learn a little bit more about this whole credit score thing. And they kind of broke things down into like what has the most impact on your credit score. And obviously, defaults and these type of things, 30, 60, 90-day late, I mean, those are the biggest … or defaults, foreclosures. And these things obviously have the biggest impact on it. But one of the other biggest things is really your credit utilization.

Dr. Kim: And so if people can be smart and smart about what gets reported on a monthly basis to these credit agencies, for example, by either paying off their credit cards a little bit early so it doesn’t get reported there, these kinds of things have far more impact on your credit score than a couple checks on it is what I found. And those things recover quite quickly. And by refinancing your loans, number one, it really won’t impact your credit score significantly by a couple of those credit score pulls, but what it will help you do is in the debt to income ratio, especially if your payments … again, depending on what kind of … what they refi into and what those payments end up being, often times, that can kinda help you actually get the mortgage that you need.

WCI: Any trends you’ve noticed with Curbside in the last year?
Anything that seems to be happening in this physician housing market that you’ve noticed?

Dr. Kim: Yeah. We’ve actually noticed that it’s gotten easier for our physician clients to purchase homes. I mean, I think that in the past five or six years, with this crazy run-up that we’ve had with prices … well, especially in these areas near me, but in many parts of the country, these homes were going so fast. And the more competitive you can make your offer, the more likely you were to get into a home especially with multiple offers.

Dr. Kim: So when they were looking at a lot of our physician clients coming in with 0%, 5%, 10% down payment loans, they just didn’t look as competitive as somebody who was putting in 20, 30, 40% or all cash. Now, as the market softened quite a bit and as supply has increased, I mean, you’re seeing things sitting on the market for a little longer. Now, these physician-clients that are coming in and trying to actually buy the house with lower down payments, they’re a lot more attractive and they’re a lot more competitive.

Dr. Kim: So I’ve noticed that a lot of the physician clients that we are working with even two years ago, three years ago, I mean, it would take them a very, very long time for some of their offers to get accepted on multiple homes, this sort of thing. But the thing I’ve noticed in the last 3 to 6 months, oh, I mean people are really going after these physician clients, and they’re getting their offer accepted.

WCI: How many doctors has Curbside been able to serve in the last year?

Dr. Kim: In the last year? It’s definitely been a few hundred, a few hundred physicians. And it’s just continuing to grow, I would say pretty much at an exponential rate as people are just telling their friends about it. So it’s really been great. I think that feels good, and kind of hopefully makes us
feel like we’re doing a good job.

WCI: Let’s talk about realtors for a minute. A big part of your businesses is basically connecting doctors with realtors. What do you think about realtors? What value do you see them adding? Do you think they’re worth using for buying, selling, both? And what do you think about that classic 6% commission structure?

Dr. Kim: That’s a lot of questions there, but I’ll try to tackle it one by one. I have a lot of … obviously, I have a lot of good relationships with a lot of realtors. I guess, and in actuality, I have my real estate broker’s license too as well. So I understand that market. I don’t go out and buy homes for people or sell homes, but I got it myself just so I can learn a little bit more about the industry, what they do and what value they bring.

Dr. Kim: And having been behind that, I actually think they can bring a significant amount of value. I mean, when I went through the process, again, it’s not necessarily a hard process to get your license, a little bit harder process to get your broker’s license, which is what I have, but a lot of it deals with regulations and making sure disclosures and disclaimers, and making sure all these things within this contract are done correctly. And these are things that I think if I were just to go out there and try to purchase my own home, I would have no idea about any of these things.

Dr. Kim: And just kind of making sure that you navigate a few of these things correctly, oh, that can change a whole transaction. It may not even get you into the … you may not even end up purchasing that home, or you may end up purchasing that home for a lot less if you’ll be able to negotiate based on some of these types of things.

Dr. Kim: I mean there are some things I didn’t even know I can negotiate. I think that really has to do with the realtor and
kind of the knowledge, especially that I’ve learned behind the scenes. But when I went to go buy some investment properties, which I’ve done, I still use realtors. I think they have a better understanding of the market. They know what things can be negotiated. And sometimes it’s easier for me to negotiate through a third-party. And also, again, I feel like I’m not … you’re not really paying for them as the buyer. I mean, I guess it’s really technically coming from the seller. And so having somebody to kind of have another set of eyes on that contract, taking a look at that, understanding that local market, I think it adds a lot of value especially on this type of purchase that you hope to be in for 5, 7, 10 years and it’s probably the biggest purchase of your life.

WCI: Especially in California.

Dr. Kim: Yes, especially in California. So I love … I mean for me particularly, I like having a realtor on my side. Now I understand there are certain people who have been through this process before. They understand it. They know how to read that contract. They understand the ins and outs of what they can ask for, what they negotiate, and they feel comfortable with it. Then if that’s the case, I mean perhaps they could go directly to the seller, or go to the seller’s agent and try to negotiate maybe something else additional off by not bringing a realtor to the table, and I say go for it. If you’re comfortable with it, do it.

Dr. Kim: A lot of times, the people that come to us also happen just to be buying in a different state. They’re relocating for whatever reason. They are moving to that area, and they just don’t know anybody. So sometimes they need somebody on the boots on the ground to kind of help them through that process. So that’s been really helpful that I’ve noticed.

Dr. Kim: Now, you mentioned selling. I think that’s a heated discussion I mean, on your group too. I mean, at WCI, I mean,
the White Coat Investor’s Group, there’s a lot of discussion about that. Should I have a seller’s agent or not? Should I save that 6%, or in our case here, it’s typically 5%? You’re not really saving the 5%. It’s that half that you would give to your agent, which would be two and a half, or 3%. Is it worth saving that two and a half, 3% to not have representation? Again, that’s a personal decision. If you feel comfortable with the process enough to make sure that everything on the contract is done, all of the disclosures are done correctly, and that if something gets in a little bit of a hairy situation that you can handle it, then that’s fine. Go for it.

Dr. Kim: I mean, I think these days with the resources online and I think the For Sale By Owner, FSBO, is a good site for that where they kind of help owners ultimately sell their own homes without representation, there are some resources for that. I think there are some contracts there that you can look at. And if you feel comfortable with it, I say go for it. I never try to stop anybody from doing that. I mean, there are people that come to us all the time that just want some help with some guidance towards physician loans, but they say, “I want to represent myself on the realtor side,” I say, “Sure. Go for it. But if you need help, then we’ll definitely connect you to someone.”

Dr. Kim: I think things are changing in that industry. I mean, obviously you’ve seen Redfin come along, and they’ve kind of changed the model a little bit where they’ve decreased the percentage for their selling agents. I still think they compensate those agents elsewhere, but yeah, I mean, some people do that, but they may be getting a different level of service. But, again, it’s very, very … it’s to the individual situation.

WCI: Yeah, I think a lot of the criticism comes because it’s … it’s like asset under management fees for financial advisors. All of a sudden, the guy with the two-million-dollar
California house is paying four times as much as the guy with the 500,000-dollar Utah house. Same house. Same amount of work to sell it, and yet in California, you pay four times as much for it. I think that’s probably what is driving a lot of these disrupting companies that are trying to disrupt the industry in this space. They’re looking at and saying, “That’s a lot of money to pay 5 or 6% of a two-million-dollar house.”

WCI: Do you think these companies that are trying to disrupt the industry, do you think they’re gonna be successful in the long run?

Dr. Kim: You know, I’ve asked that same agents… sorry, that same question about the agents that I work with. I mean, do they think that their job will be around at 10 years, 20 years? But everyone seems to be pretty confident that they’ll still be there. I mean, they talk a lot about it in that industry and they feel it’s still a relationship business. People like to have people guiding them through these type of things, and maybe not just something online that kind of just matches the lowest price somebody will go with the highest price someone else will pay. And I think people know that there are a lot of nuances to every transaction. And so people … there will be a subset of people that will prefer some of these online platforms that just kinda match you up like a match, but then I think a lot of people will still want that personal care to make sure everything gets done correctly.

Dr. Kim: Now, I think one of the things that people do worry about that you kind of mentioned that we didn’t mention is that the incentives. I mean, I think people don’t like the fact that they feel like agents are just incentivized to get the deal done. I think that’s something important to address. And that’s … can truly be the case. I mean, they have a commission sitting there waiting for them as they represent you if that transaction gets done. So maybe they want to push that transaction and get it done.
Dr. Kim: I think some of that can be there. And I think that’s the concern with just choosing whatever agent that you want to choose. And I think it really helps to make sure that you understand who that agent is, what their history is, and what kind of relationship that they’re looking for.

WCI: Yeah, I’ve often wondered if it would be more interesting to structure the commission as rather than just percentage of the entire deal, a higher percentage of the amount over a certain amount to really incentivize them to sell it for as much as they can. I don’t know that I’ve ever actually seen a contract structured that way, but the more I think about it, the more that’s how I think maybe it should be structured.

Dr. Kim: Yeah, I mean it’s possible in the future somebody can figure that out and make that happen.

WCI: I think there’s a lot of inertia in the industry that’s keeping it from happening. I guess I wouldn’t be surprised 10 years from now if we’re doing this particular business very differently. Let’s turn for a minute to talk about physician mortgages. Can you explain to listeners what a physician or a doctor mortgage loan is?

Dr. Kim: Sure. I think these things were created actually initially by Bank of America. I mean, somehow somewhere down the line years ago, they figured out that physicians are in a unique position. They come out a little later in life with good incomes but high student loan debt and not a lot saved up for a down payment, and they were, by traditional methods, these people are having a hard time getting a conventional loan because of their debt to income ratios and just not having a lot saved up.

Dr. Kim: But at the same time, I think they started noticing that the default rates amongst physician borrowers were the lowest if not … yeah, I think about the lowest in terms of any population out there that they were working with. I mean,
physicians, they will find a way to pay their mortgage, whether that means finding another job, working harder, getting paid more at work. I mean, they will stay in there. And maybe that’s just the nature of what physicians are like, and what their work ethic and these kind of things, and their priorities so they tried to figure out, “Okay, how can we help these physicians ultimately get into these homes when they want, even though they don’t have those…” I mean, again, they don’t have a lot saved up.

Dr. Kim: So they figured out a way to structure the loan so that these physicians, depending on the type of home, or the size of the home and the size of the loan, to get in there with 0, 5 10% down instead of the typical 20%, and that’s usually attached to a fee that normal people have to pay whenever the down payment is lower than 20%. That’s called PMI or private mortgage insurance, and that can add up to a significant amount over time.

Dr. Kim: Well, they decided, “Okay, well, for these physicians, we’ll be able to do these loans and we won’t charge them a PMI.” But what they often do is on the back end with the rate, because they are giving at a lower down payment, maybe it’s slightly higher. Now, that’s not always the case, but oftentimes that’s what you’ll find.

Dr. Kim: And so that’s … a lot of physicians … I mean, I used one myself. When I came out, especially trying to buy a home here in Los Angeles where the price points are significantly high, unfortunately, we didn’t have that saved up through residency. We had a little bit saved up, but not that much. And we wanted to get into our home. So the only option for us was to use one of these physician loans where, I don’t know, we use a different down payment loan, a lower down payment. And for us, it worked out great, otherwise, we wouldn’t have gotten into our home, and at this point again, the appreciation was happening so quickly and so fast here, we would have been priced out.
WCI: Now, are you still on the same loan or have you refinanced out of that loan?

Dr. Kim: I have refinanced actually since.

WCI: So when is it a good idea to use one of these versus using a conventional mortgage?

Dr. Kim: Well, I mean, if you have the option, there’s a couple of things that you have to consider. Number one, just compare first of all. Each bank that you work with, if they’re offering you a physician loan, they can offer you a conventional loan. So see what those interest rates are and you can do a little bit of a calculation to see what might make sense. I guess part of the question is if you had that option, would you do 20% or would you put down 10%? I guess the question is what would you do with that difference in that down payment? I mean, there’s an opportunity cost, I guess, of having it in your home versus not being out there and being used for something else.

Dr. Kim: And for some people who are possibly quite savvy or they have some other options for it, they may think, “Oh, it makes more sense for me to take that amount and invest it elsewhere.” Now if … you just have to know where you put that. Now, some people will take that money and just do other things with it, buy a nice car and do these type of things, which is again, if that’s what they want to do, that’s what they want to do, but you just have to know what the opportunity cost is for not having that money in the home and have a plan for it at the end of the day.

Dr. Kim: So I never tell people what’s the right decision there. I think we go over these scenarios. We talked about what their other interests are, whether it’s investing in real estate, or putting that in the stock market, or these type of things. Look at the market that’s kind of around them at that time, see what the different rates are, what the different
payments are, how that ultimately kind of adds up over time, and then make a decision from there.

WCI: Yeah, I think that’s exactly the approach to take. You got to ask what else are you gonna do with the money? Now, I’ve never bought with a physician loan. Our last two purchases were the conventional loan, and we had a down payment, but I was also able to max out all of my retirement accounts. I didn’t have any other student loans or any other kind of even moderate interest debt to pay off, and so it seemed like a good use to us of that money. But I think someone that’s got a bunch of 7% student loans and it’s otherwise the right time for them to buy a house for personal and professional stability reasons, I think it’s okay to use that money on the student loans rather than the down payment, use a doctor loan.

WCI: What mistakes have you seen doctors make when financing a home?

Dr. Kim: I think the number one thing when people look for financing a home, when they look for a physician home loan is they just go after whoever dangles the best rate in front of them. I mean, that’s what they do. They go out and everyone’s used to kind of using these comparison sites, and so they kind of want to do the exact same thing for physician home loans, and they just go for the one that dangles the lowest rate in front of them.

Dr. Kim: Unfortunately, what happens is that nobody can guarantee you those loans, at least that rate, until you’re actually in escrow on the property. What that means is that your offer has been accepted, the contract has been signed, and then you can go back to that same lender and lock in a rate. Now, what people tend to find is that when you go to lock in that rate, it’s not necessarily a loan that they initially told you that you would get. I mean, the market changes. Market changes often times, rates change twice a day,
whatever the Fed’s doing. Things slowly kind of change over time and maybe you were looking 30 days ago, but I think people chase the lowest rate and they don’t necessarily think about the service that they’re gonna get.

Dr. Kim: I mean, we have people come to us … I mean, not a lot, but it definitely happens to us, where they’re late in the process. They need their loan to go through, and a lot of these deadlines are getting close to the end, and the bank, even though they promised them a certain rate, just ultimately either based on some other indicating factors or that they kind of reveal to them, oh, they had to jump the rate another half percent because of that. They felt like maybe a little bit of a bait and switch, or they kind of get to the end and they say, “You know what, unfortunately, we’re not gonna be able to offer this loan. There are some issues here and there.”

Dr. Kim: And I think people, often times, just get tricked into certain lenders because of just the rate that’s dangled in front of them. So I think it’s important to understand the ability for that lender to close, what their track record is, and who you’re working with at that particular bank. I mean, it does matter. I mean, you can go to the same bank and try to get a loan there, and it does matter who the loan officer and the front person that you’re working with because depending on how they package you, how they kind of counsel you from the beginning, some of them will know from the very beginning that you will not really qualify for this loan at our bank, so it’s not even worth trying. I mean, so it doesn’t matter who you go to.

WCI: Thanks very much. I think we’re getting short on time here. We better wrap this up. But thank you, Dr. Kim, for being on the podcast today and for sharing your expertise on these subjects.

Dr. Kim: Cool. Thanks for having me. I mean, people can reach
out to us anytime. We’re just happy to talk about home buying, whatever the topic is. Yeah, that’s our passion. We love it.

WCI: Thank you so much.

Dr. Kim: Thanks.

WCI: This episode was sponsored by Curbside Real Estate.com, a free real estate concierge service for physicians by physicians. After struggling through his first home purchase, Dr. Peter Kim founded Curbside Real Estate to address physician-specific issues encountered during the home-buying process. In addition to providing news and information, curbsiderealestate.com is your physician-led Curbside consult for physician home loans, expert real estate agents, relocation and everything in between.

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Cash-on-Cash Return: the Most Important Calculation in Investing?

[Editor’s Note: The following post is from WCI Network partner, Passive Income, MD and is about evaluating investments using the cash-on-cash return metric. We sometimes forget that basic division can give an insightful first look at an investment’s potential yield. Enjoy!]

What’s the best way to evaluate an investment?

Someone posted in on our Facebook group, Passive Income Docs, recently about the desire for a certain return on investment (ROI).

Though we talked about many potential ways to evaluate investments, one interesting thread of the discussion was based around cash-on-cash (CoC) returns vs internal rates of return (IRR).
It’s always tricky figuring out how to best evaluate an opportunity, so I thought it might be important to discuss and explore key terms like this. They’re integral to understanding the various investments we come across in crowdfunding, syndications, funds, and rental real estate.

The cash-on-cash return, specifically, is one of the simplest and most effective ways of calculating the return an investment will likely yield.

How Do You Calculate Cash-on-Cash Return?

Like most real estate calculations, it’s pretty simple. You take the amount you receive (in cash) from your investment and divide by the total amount you invested. Use the pre-tax amount as the numerator.

\[
\text{Cash on Cash Return} = \frac{\text{Annual Before Tax Cash Flow}}{\text{Total Cash Invested}}
\]

So for example, let’s say you put $10,000 into a real estate crowdfunding deal (Total Cash Invested) and you receive $1000 over the course of the year (Annual Before Tax Cash Flow). This scenario yields a 10% cash-on-cash return.
($1000/$10,000).

When looking at a rental property it might look something like this:

\[
\text{Cash on Cash Return} = \frac{\text{Net Operating Income} - \text{Debt Service}}{\text{Down Payment}}
\]

Net Operating Income = Revenue (Rent + Other Income) - Expenses

Debt Service = Mortgage Payment (Principal + Interest)

**Strengths of Cash-on-Cash Return**

**Simplicity**

The greatest strength of the cash-on-cash calculation lies in its simplicity. While metrics like Internal Rate of Return can be quite confusing, people can wrap their heads around this calculation much more easily. You simply put a certain amount in and you get a certain percentage return back in your pocket.
Helps You to Compare Investments Quickly

You can also use CoC to compare investments quickly. If you have an average of what an investment might yield, as well as how much you may want to invest, the CoC calculation can quickly help you see the investments with the highest return potential. As a preliminary comparison tool, it’s hard to beat.

See How Changing Certain Factors Could Affect Your Returns

You can use it to evaluate an investment after changing certain factors like how much you leverage the property.

For example, if you paid all cash for a certain property and you received a certain amount, you might receive an 8% return. But what if you used leverage instead by taking out a loan and putting down 30%. How does that change your return? One way to assess these different scenarios is by using cash on cash return and that might help you determine how much leverage to use.

Encouragement and Motivation

Cash-on-Cash return provides a good amount of encouragement and motivation. It’s nice to watch your stock portfolio go up and down, but to me, nothing is as exciting as getting that check or deposit at the beginning of each month from my cash-flowing passive income ventures. Even though it takes some work to get there, that extra check feels like a monthly bonus.

It’s encouraging to see and to know that you didn’t have to put in an extra call night at the hospital to receive that deposit. It pushes me to do more and makes me hungrier for more time freedom.
You Can Live Off of It

Finally, if you’re using the cash flow from certain investments as passive income to live off of and retire gradually like I am, using your cash-on-cash evaluation is huge for knowing if you’ll have enough to cover your expenses. If your passive income provides that type of positive cash flow, you can live the life you want.

For example, if your passive income goal is $10,000 a month through investments ($120,000 a year), and you get an 8% cash-on-cash return from a total of $3,000,000 in investments out there working, you’ll most likely have exceeded your goals after taxes. To do that calculation quickly:

\[ 3,000,000 \times 0.08 \text{ (cash on cash return)} = \$240,000 \]

And how do taxes affect things? Read on.

Weaknesses of Cash-On-Cash Return

Regarding Taxes

Cash-on-Cash return doesn’t take taxes into account. Everyone’s tax situation is different, as is how the investments are treated. It’s important to consider where you live as well as the concept of depreciation.

For example, I live in a high cost-of-living area, in California, where the state income tax at the highest bracket is 13.3%. My friends living in Texas, where the state income tax is a big fat 0%, would look at CoC returns very differently than I would.

What is depreciation? Well, the IRS allows you to depreciate
the cost of a residential real estate property over 27.5 years of useful life (residential real estate) and offset your rental income. It’s a huge benefit of investing in real estate.

Underreports Your Profit Potential

The CoC calculation may also underreport your actual profit, as it doesn’t take into account mortgage or principal paydown and appreciation. Sure you end up with a certain amount in your pocket monthly or by the end of the year, but that’s only part of the profit picture.

While your mortgage is being calculated as an expense, in reality, a portion of it goes toward the interest payment and a portion goes toward paying the principal down. So it is being paid off over time by your tenant, increasing your equity position in the property.

Speaking of equity, over time the property is likely appreciating in value. That doesn’t show up as yearly money in your pocket while you hold it, but it will definitely show up
when you go to sell the place.

**Should You Evaluate Using Only Cash-On-Cash?**

Well, the answer is no. There are other factors at play, including risk and opportunity cost and Cash-on-Cash doesn’t account for them. Because both are important ideas to consider, let’s take a look at each.

**Risk**

Returns often correlate with risk. So if you’re going strictly by what can get you the most returns without taking into account risk, you probably went heavy in bitcoin when it was fluctuating wildly and was frenzied.

In real estate, you have to look at risk as well. What kind of project are you pursuing? For example, ground-up development can have amazing potential but there’s also a ton of risk involved. Paying close attention to risk is always important in addition to just a pure Cash-on-Cash Return number.

**Opportunity Cost**

Are there better places to put your money? Well, if you decide by only using a CoC calculation, you might be tempted to think about opportunity cost and always chase the highest cash-on-cash.

For example, many have struggled with the idea of the “pay down debt vs invest” dilemma. Basing that decision on cash-on-cash would tip the scales in one direction, but paying down debt is essentially a guaranteed return. It’s lowering the interest that you would definitely be paying in the future. In situations like these, CoC may not be the best fit for your decision-making process.
The Bottom Line

There’s a huge difference in investing purely for speculation versus investing for cash flow. Positive cash flow allows for operations to continue when revenue drops a bit.

It’s steady, and it’s why, in 2008, owners of rental properties that had cash flow didn’t bat an eye. Speculators, developers, and fix and flippers, on the other hand, got crushed.

Positive cash flow is a good metric that keeps you from overleveraging and putting yourself in a tough financial situation.

Ultimately, my goal is to help you look at investments wisely and smartly as I’m learning how to continually improve myself in the same way. Understanding how to vet opportunities starts with the numbers, and I can’t think of many better places to start by looking at the cash-on-cash return.

*How important do you think this metric is? How do you use cash-on-cash return to decide what investments to make?*
ESG and Impact Investing
Pro/Con

[This post grew out of a WCI Forum discussion where a new poster was concerned about the ethics of investing in all stocks, including those companies whose missions the investor disagreed with. Chris Hughes, CFP, a wealth advisor with the Del Monte Group took exception to the tack that most of the forum participants took on the topic and decided to submit a guest post arguing his point of view. His submission will constitute the “PRO” portion of this post, and I will take the “CON” point of view. We have no financial relationship.]

Pro — Dispelling Common Objections about ESG and Impact Investing

Environmental, social and governance (ESG) and impact investing are not well understood – and rightfully so, given they are relatively new on the scene. In a conversation on the WCI Forum, several comments typify the objections and questions that people have about this topic: it’s too expensive, doesn’t create real benefit to society, and underperforms. These are many of the same concerns voiced by
the population at large. This article will offer fact-based rebuttals to these objections that this discussion failed to consider.

Objection #1: ESGs are More Expensive and Underperform Regular Stocks

WCI Forum comments:

“You can look up ESG funds and try to find a good one...It will definitively have higher expenses and likely have lower returns.”

“You can dig down deeper and do socially responsible investing and/or impact investing, but these options get more expensive. Heck, there are companies like SEI who design Sharia, Baptist and Catholic portfolios. They are not cheap but they are an option.”

“Unfortunately, most normal people are priced out of best social options.”

“You’re fees are likely to be higher and your returns are likely to be lower. You will be donating money to Wall Street that could have gone to provide for your favorite charities doing good in the world.”

Performance and Fees

I can’t argue about the performance of sustainable investing for a few reasons. One, there isn’t as much long term data available upon which to base these conclusions. Conventional market data goes back 90+ years. We’re still in the nascent stages of ESG and impact investing and have less than 20 years of data to judge.

It’s obvious that having an ESG portfolio custom designed as a separately managed account is going to be more expensive and
prohibitive for investors who fail to meet the minimum size. This doesn’t mean that you can’t engage in sustainable investing through mutual funds (or even better, ETFS) on your own. ETFs tend to carry lower expense ratios than mutual funds and the number of sustainable ETFs is rapidly growing in response to market demand.

Here’s where critics’ views can be a bit myopic, however. In general, you stand to lose way more value by improper asset allocation, poor tactical decisions such as market timing, failure to diversify, and lack of attention paid to tax sensitivity. These are the factors that move the needle way more than any one investment bearing slightly higher fees or slightly lower performance.

**Taxes**

Do you realize that taxes are the single largest transfer of wealth that any person will ever experience in their lifetime? Yet how many high earning people with substantial investment portfolios sit down with their tax advisor once or twice a year and actually look at things such as:

- The best way to use tax loss carry forwards for the year
- If tax loss harvesting of concentrated positions is necessary
• What they are losing by being in certain mutual funds that make distributions whether or not the shares actually go up
• How much they are paying in capital gains tax by being in high turnover funds that sell positions at a gain that they may or may not personally have a gain from
• Whether or not their bond holdings are triggering AMT

How many people use a financial advisor who is also a tax advisor? This would provide ongoing tax advisory which would allow for maximum efficiency. Yet few people do. Most advisors are not also tax advisors and they pay very little attention to taxes other than at the end of the year.

Asset Allocation

Asset allocation refers to the mix of stocks, bonds, derivatives, and cash in your portfolio. Investments fluctuate in the short term, but having the portfolio aligned with your risk and return goals is what is ultimately going to be responsible for getting you where you want to be in the long term. If you want proof, check out this pension study which shows that “investment policy dominates investment strategy (market timing and security selection), explaining on average 95.6 percent of the variation in total plan return” (Brinson et al., 1995).
Objection #2: ESG Investing Doesn’t Actually Create an Impact on the Company

Forum comments:

“All you accomplish by investing in these funds is making yourself feel good while simultaneously harming your expected future net worth.”

“Your stake in a company through a mutual fund isn’t what is allowing that company to do bad things. You own fractionally none of it from a statistical standpoint. It’s the littering equivalent of dropping a paper gum wrapper on the ground once every 3 months.”

“Your money isn’t going to the company and its founders unless you’re buying it at an IPO. It’s going to the last guy who owned it, probably a mutual fund or pension. You’re not hurting anyone or affecting anything by avoiding investing in the stock of a “bad company.”

Several Ways Investors CAN Influence a Company

If stock price didn’t matter, then why should management care? I agree; there would be no point in trying to influence stock price if it had no impact on the company’s wellbeing. But in reality, there are several ways that it does.

1. Having positive momentum on the stock price bodes well for companies seeking equity (or even debt, for that matter) financing. Better financing means that the company can pay down debt, fund growth projects, and even enact a merger or acquisition more readily.
2. If there’s not enough demand for the stock, a company may have to sell additional shares to gain capital funding. This may lead to share dilution which impacts the holders of existing shares. It then becomes a never ending cycle of more people dumping the stock causing
more downward pressure on the stock price.

3. The street looks at stock price as a barometer for the performance of its management. Falling shares and the perception of shareholder disapproval, to a large enough extent, results in the Board of Directors giving leadership the ax. Remember that the Board of Director is voted in through proxy by you, the shareholders.

4. While it’s true that shares are exchanged from investor to investor without directly putting cash in the company’s pocket, a lower stock price hurts compensation if management is holding stock options. When the shares are in the tank, the options have no value.

5. Falling share prices are often the target of media attention and negative press never helps any company.

Objection #3: Too Hard to Attack One Particular Problem

Forum Comments:

“There are no truly bad companies. Take the armaments sector that you don’t want to support... If you exclude such companies, what you are left with may not produce the market returns.”

“Your ‘bad companies’ are completely different from someone
else’s. And the chances that your list overlaps precisely with that of a mutual fund manager is essentially nil. The world is a very gray place.”

Focus on Companies that Create Positive Outcomes

Most investors fail to realize the difference between Environmental, Social and Governance (ESG), impact investing, and Socially Responsible investing (SRI). ESG and impact investing look to promote companies who do good for society. SRI, on the other hand, excludes companies that are not socially beneficial.

I agree that an SRI approach can be so limiting that market-level returns become impossible. If you were to exclude every single company that offends some ESG criteria, it becomes pretty hard to reap the return that the market has to offer. And moreover, given that everyone’s personal preference is different, customization may be expensive.

If this is your concern, then focus on companies who create positive outcomes rather than avoiding those who do bad. You’ll find way more options that way, and fund companies are only increasing their offerings as a response to burgeoning demand. There are several mutual funds and ETFs that focus on a particular purpose (e.g. encouraging women or minorities in management, clean energy, etc.)

Summary

Impact investing is still in its early stages and is by no means perfect, but most of the objections people have about participating are based upon conclusions that can be debunked upon closer examination.
CON – Impact Investing is an Expensive Way to Make You Feel Better

I’m not sure this CON section even needs to be written. Between the quotes cited above and Mr. Hughes’s own comments, I think he debunks most of his own arguments. Longtime readers know I am not a fan of Environment Social Governance Investing (ESG), Socially Responsible Investing (SRI), Impact Investing, Sustainable Investing, or whatever its next name will be for reasons explained well by forum participants above. However, it seems worthwhile to make a few comments about Mr. Hughes’s rebuttal.

Impact is Expensive Active Management

At risk of going “ad hominem”, when you see an article like the one above, the first thing you should do is ask yourself, “Self, who goes to the trouble to write an article like that?” And the logical answer should be “Someone who benefits financially from convincing you to invest in this manner.” Is that the case with Mr. Hughes? I’ll let you be the judge, but there is an entire page on his firm’s site about “Sustainable Investing” where the firm encourages you to invest in this way.
Sustainable Investing

Want to make a positive impact on the world with your investment dollars by investing with your heart AND your head?

We value the environment, admire companies that are socially responsible, and believe in the value of good governance. We have found a way to help our clients take advantage of this new era of “investing with their hearts.”

OUR DEFINITION OF SUSTAINABLE INVESTING:
There are many definitions of Sustainable Investing. Our method combines traditional investment approaches with environmental, social, and governance (ESG) insights to help manage risk and enhance long-term return. As always, we remain evidence-based.

ESG FACTORS CONSIDERED IN INVESTMENT CHOICES:

**ENVIRONMENTAL**
- Climate change and carbon emissions
- Air and water pollution
- Waste management
- Water stress
- Natural resource conservation

**SOCIAL**
- Health and safety of employees
- Data protection and privacy
- Community relations
- Customer satisfaction
- Human rights

**GOVERNANCE**
- Board and executive diversity
- Executive compensation
- Business ethics
- Lobbying activities
- Audit committee structure

That sounds awesome, doesn’t it? You can change the world. Who doesn’t want to help the environment? Who is against being socially responsible or governing well? Nobody. I mean,
everyone likes cupcakes and unicorns. But let’s peel off the
marketing here and look at what is really going on. A good
place to start with any advisory firm is the ADV2. In this
case, we’ll take a look at Item 5 (Fees) and Item 8
(Investment Strategies) for Mr. Hughes’s Del Monte Group
advisory firm.

1. **Investment Advisory Services**
   The client can determine to engage the Registrant to provide discretionary
   investment advisory services on a fee basis primarily in accordance with one or more
   of the Registrant's four (4) portfolio objectives: Conservative, Balanced, Growth &
   Income, and Growth. The Registrant’s annual investment advisory fee is based upon
   a percentage (%) of the market value of the assets placed under the Registrant’s
   management, generally ranging from .65%-2% in accordance with the fee
   schedule attached to the Investment Advisory Agreement between the Registrant
   and the client. The client may, at any time, impose reasonable restrictions, in
   writing, on the Registrant's services.

Let me summarize for you. This firm charges its clients AUM
fees of up to 2% per year and has chosen not to reveal how
that AUM fee is determined or where break points might be
either in its ADV2 or on its website. Aside from the fact that
2% is twice the “industry standard” 1% (which is already _far
too high_ for anyone with a seven figure portfolio), it is
pretty obvious that the firm is not going to compete with its
competitors primarily on price. (There’s a reason the fees are
not prominently posted on the website.) So it must find
something else with which to distinguish itself from its
competitors. Perhaps that “something else” is “Sustainable
Investing.” Let’s move on to the investing strategies of the
firm.

**Item 8 Methods of Analysis, Investment Strategies and Risk of Loss**

A. The Registrant shall utilize the following methods of security analysis:
   - **Fundamental** - (analysis performed on historical and present data, with the goal of
     making financial forecasts)

   The Registrant shall utilize the following investment strategies when implementing
   investment advice given to clients:
   - **Long Term Purchases** (securities held at least a year)
   - **Short Term Purchases** (securities sold within a year)
It doesn’t actually say anything about impact investing there, but I would presume from the website that their strategy is at least partially based on Impact. I’ve looked at a lot of these and this one is much more vague than most, but as near as I can tell, the firm’s main strategy is to pick stocks, bonds, and mutual funds that the firm’s crystal ball says will do well in the future. Its two strategies involve holding on to investments for either more or less than a year. I don’t mean to be critical, but it’s hard to take anything else from the firm seriously when this is how the ADV2 describes their work. Maybe they didn’t expect anyone to actually read this, I don’t know.
For those who are new to this whole investing thing, this is called active management, and it doesn’t work. One of the reasons it doesn’t work is because it costs so darn much. How much does it cost? Well, the “Top 5 ESG Funds” recommended by Kiplinger have expense ratios ranging from 0.65% to 1.01%, 16-33 times as expensive as just buying all the stocks at Fidelity, Schwab, or Vanguard via a Total Stock Market Index Fund. Are the ESG ETFs any better? Not according to Forbes. The cheapest of their “Best Socially Conscious ETFs” costs 45 times a total market ETF, plus they are small and illiquid—good reasons to avoid any ETF. Now add those fund or ETF expenses on to the advisory fees of a firm like Mr. Hughes, and you’re already looking at a hurdle of 2-3% that the active manager has to overcome. Now handcuff him with an “Impact Mandate” and your chances of long-term outperformance against a true index fund rapidly approach 0%.

So, in reality, your choices are:

A) Invest in an index fund and use your excellent returns to support your favorite charities or

B) Hire an expensive manager to pick an expensive fund or ETF (or worse, choose the stocks himself) and not have enough money to retire comfortably yourself, much less be able to support a charity. Instead of your money going to support charity, it is going to Wall Street.
The choice is yours. However, Mr. Hughes is certainly correct when he says “We can’t argue about the performance of sustainable investing” because the track record of active management is terrible and is highly likely to continue to be terrible. ESG funds are probably too new to really say how terrible, but the record of SRI funds demonstrates that active SRI funds are about as crummy as active non-SRI funds. Hughes’s counterargument, that other things like asset allocation, taxes, and fees matter more, is silly. That’s like saying after your heart attack not to worry about your hypertension because your diabetes and your smoking habit matter more. In reality, ESG investing is just a new way for Wall Street to sell you active management by appealing to your emotions. “It’s your duty to get lower returns in order to save the planet and society.” I call B.S. As noted by Reuters,

“Investors in ESG products tend to be more patient and care less about performance than investors in traditionally-managed products, so there might not be the same push to pull assets when a product has underperformed.”

ESG-focused funds have been one of the few bright spots for the actively-managed fund industry at a time when lower-cost ETFs and passive index funds are drawing assets, in large part since sustainable strategies often require more research and stock selection that is not easily replicated in an index....Financial advisors who focus on ESG investing say that they expect that index providers will create more tailored products, such as the SPDR SSGA Gender Diversity ETF and the iShares MSCI ACWI Low Carbon Target ETF, that will draw more investors out of actively-managed funds.
Active management still doesn’t work, even when you pair it with unicorns and rainbows. These are the kinds of ETFs that Jack Bogle warned about.

*Exchange-traded funds are overrated* and in some cases flat-out dangerous….

When you get into ETFs and their rapid growth, *it has certainly become a marketing business*. We now have one that’s short retail and long electronic marketing. Talk about a product of the times…And we’ve got the Republican and the Democratic ETFs, and the drinkers and the distillers. And where it ends nobody knows.

*ETFs have become the new way to speculate*…even though many ETFs are in fact index-based. There’s a lot of niche-seeking…There’s a lot of junk out there.

However, in all fairness, I must concede a point here that I did not expect to have to concede as I started to write this post. Are there social INDEX funds? There are. Vanguard has one (and a new ETF or two.) Its returns are actually not too bad. (Beats the 500 index over 10 years, but not over 15 years.) So if you do decide to do Impact Investing, stick with passive investing as usual. But it does NOT appear that we have proven conclusively that just having an Impact mission
definitely causes lower returns. The main problem, as usual, is high fees from advisors and high costs and poor performance from active managers. If you can avoid those two things, perhaps it isn’t crazy to try to invest “responsibly.”

**Impact Investing Doesn’t Make a Difference To Stock Price**

Mr. Hughes argues that lower stock prices do matter to management. I find that argument weak but plausible. Where he fails to convince, however, is that Impact Investing actually lowers stock prices for “bad companies,” that it actually has an impact. If the ESG funds avoid the stocks, the Sin funds pick them up. In case you’re wondering, Sin funds outperform ESG funds, but both underperform their respective index fund. But the point is that just because YOU don’t own these stocks doesn’t mean nobody will. In fact, the more the stocks of these profitable companies are avoided by investors, the better investment the stock becomes. Remember what a stock is—a share of a company and its profits. Buying those profits at a lower price per dollar of profits is a good thing. If you really want to hurt a company whose mission you disagree with, then boycott their products, not their stock.

**One Person’s Good Stock is Another’s Bad Stock**

Bad companies are in the eye of the beholder. The military vet might despise a marijuana company and love a firearms company. The local hippie might love marijuana and hate guns. Mr. Hughes’s argument against this, that you should just buy the good companies instead of avoiding the bad companies, is like something out of Alice in Wonderland. Buying shares of a tiny illiquid ETF that only buys shares of companies that have minorities in management isn’t going to change a thing other than transfer money out of your pocket into that of the Wall Street croupiers who think you’re dumb enough to buy what
Want to change the world through investing? You will do a lot more good by buying low-cost index funds and **donating the excess returns to charity** than you will by purchasing expensive, thinly-traded ETFs or individual stocks and donating the excess returns to the financial services industry.

I get questions all the time about investing in outpatient surgery centers. Given that I’m not a surgeon, nor have I been involved in one of these businesses, it is difficult for me to answer those questions, so I’ve never discussed them on the blog or the podcast. But recently Dr. D, an ophthalmologist, emailed about an opportunity he had to invest in an Ambulatory Surgical Center earlier in his career than he anticipated. He wanted me to discuss ways to prepare for practice and ASC buy-ins, and how that fits in with paying off debt and saving for retirement. So I reached out to the WCI email list and asked for anyone with experience investing in ASCs that wanted to come on the podcast and talk about it. Dr. L, an OB-GYN, has fairly extensive experience owning a surgery center. There was a physician-run surgery center that his practice was affiliated with initially but the current owners were writing checks every month to meet the bills and pay off the loan debts. It had been in existence for several years and just was not profitable. His partners were encouraging him to utilize the center, obviously because it benefited them, but it wasn’t a convenient location for him. As his practice got busier he noticed the inefficiencies that can exist in a hospital for surgeons, and at this same time, a management company became interested in the center that his partners owned. The management company thought they could come in and fix the center and make it profitable. He was approached with the opportunity to buy in. The specifics of the arrangements for the center dragged out long enough that he could save up
enough money to buy his percentage of the ASC. Fortunately, within that first year, they were receiving checks. They’ve been profitable since that first year and it has been a good investment for Dr. L. In this episode, we talk about both of these doctors’ experiences buying into and practicing at an ASC and what you should be looking at when given this type of opportunity.

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**Quote of the Day**

Our quote of the day today comes from J.L. Collins, who said,

“Yes, it is possible for every middle-class wage earner to retire a millionaire, though it’s never going to happen. And that’s not because the numbers don’t work.”

I like that quote. I think that is entirely possible, if you can get yourself to a middle-class wage to become a millionaire.

**Investing in a Surgery Center**

Dr. L shared with us at the beginning of this podcast a warning – ASCs don’t always make money. His partners lost quite a bit of money writing checks each month to cover the expenses of their ASC. A management team came in and purchased 30% ownership of the center and the former owners were given the option to stay and be part of the new entity or could be released from the current debt. Some nearing retirement got out and other younger doctors stayed to see if they could make it profitable. And they brought in new doctor investors, like Dr. L. Three lessons he learned quickly are:

1. It takes a fair amount of time to manage a center correctly.
2. There is always a more efficient way to do something.
3. You can have many providers affiliated with the center, but if no one’s bringing cases there, then that surgery center is basically a really expensive closet for a bunch of expensive equipment.

So what does it mean to do it right?
The first group of doctor investors never looked at reimbursement and negotiating contracts with payers. So working on that aspect is number one. Number two, being willing to bring cases to the center. They needed to learn to utilize the center to its fullest ability. Realizing that certain types of cases could be done in an outpatient setting is something that took people time to get used to. Once people are able to realize that certain types of surgeries can be done in that type of environment, people start to feel more comfortable with doing those things in that particular setting. When people are bringing those cases to the center, then the center is being utilized and it becomes more productive.

Conflicts of Interest

We discussed any pressure or conflicts of interest to bringing cases to the center that are borderline in a gray area. Dr. L said,

“I think that was one of the things that was initially challenging for some of the partners because the center evolved at a time where things like laparoscopically and minimally invasive surgery were really being developed. So initially, a lot of these cases, things like hysterectomies and myomectomies, were done in an open manner where patients needed to be admitted to the hospital, usually overnight, sometimes two nights. But then with the advent of newer technology and more refined techniques, a lot of these cases were being done essentially at the hospital laparoscopically or in a minimally invasive way, and patients were basically going home from the hospital. So if you have a skilled group of individuals who are able to do these things in a safe manner, it’s just a matter of changing the setting where they are actually performed.

Definitely there are probably some cases that can be done at a center that shouldn’t be done at a center. But I think when
you have a group of talented individuals, not only surgeons but anesthesiologists and an O.R. team, that can do things safely, it’s just a matter of trying to change the environment where these things are being done.”

The physician fee portion of the surgery is basically the same regardless of the location of the surgery so it just the matter of collecting the profits on the facility fee for surgery.

For Dr. D, in ophthalmology, almost all surgeries are done in outpatient centers. There are very few done in a hospital unless for the convenience to the patients due to location. One of the biggest advantages is just efficiency. He literally operates in one room, goes to the next room, operates, comes back out, scrubs, operates again, where in the hospital there’s a 20-30 minute turnaround time. Since almost all surgeries are done in outpatient centers normally in ophthalmology the conflict of interest to bring patients to the ASC vs the hospital isn’t really an issue. Also for ophthalmology, 95% of what they do is elective so anytime an anesthesiologist has any question or any concern about something they usually just cancel the case.

Cost of Buy-In

I asked Dr. L what it costs him to buy in and what kind of returns he has seen on that money. The buy-in depends on what type of center it is. His ASC initially was a single specialty center, GYN only. Initially, it was losing money every month with bare bones equipment and doing types of procedures there weren’t necessarily higher acuity cases.

But the area that the center exists, real estate wise, is a little bit on the higher end of the spectrum. So just for the facility itself, it was $200,000 a year for the rental space.
And then the equipment,

“an O.R. table that’s pretty decent can be anywhere upwards of $25,000 to $30,000. You have to have anesthesia equipment for general anesthetic. That could be anywhere from 40 to 50K. If you’re gonna do laparoscopy or hysteroscopy, video towers could be another 40-50,000. And then you have to worry about things like sterilizers, autoclaves, PACU. Those little stretchers that people use, they’re actually kinda pricey. They could be anywhere from $2,000 to $3,000 each. And if you have a four-bed PACU and a four-bed recovery, that kinda adds up.”

Like a vehicle, that equipment depreciates significantly once it has been used so not a ton of resale value there. They recently renovated the center and gave it a complete facelift with about 2 million dollars. Dr. L estimates that with the equipment and renovation of a center it could cost up to $2.5 million if we were to start everything anew. And that doesn’t include staffing, daily operating costs, front house, O.R. techs, or management. For that recent renovation of his ASC, they applied for a small business loan. All of the partners individually had to sign for the loan to guarantee it.

His return on his initial investment money?

“Well from when I got in the valuation of the company was significantly less but within that first year based on my buy-in, I got about a 200% return on my investment. And then for the subsequent eight years, as we became a little bit larger, a little bit busier, and people actually felt comfortable bringing cases to the center, we were seeing upwards of anywhere from a 400-500% return on the initial investment over that time.”

For Dr. D, the surgery center is attached to his main office
building but the buy-in to the practice does not count the real estate. That’s a totally different LLC. The founding partners own the real estate and then, of course, they pay rent to them.

The one percent share in the current surgery center is about $240,000. He is being offered only a fifth of that share. On the ophthalmology side, most surgery centers are pretty profitable just because they do such a high volume of surgery and it’s been a long track record of having outpatient centers. His particular center has been here for close to 20 years. The profits per year is just a little under eight figures. The idea is that your original investment will be paid back in 4 and a quarter years. That’s the ideal. So a $240,000 should be paid back in 4 and a quarter years and after that, anything you make should be just profit on the original investment.

At those sorts of returns, it makes sense to borrow money for your share. As much as they’re willing to sell you, you wanna buy, just because the returns are spectacular at that sort of rates.

Getting Money to Invest in ASC

Dr. D’s buy-in isn’t going to be a huge chunk of money but he is just out of residency with a little bit of student loans. I asked him what was his thought process in deciding when to pay off student loans, when to put it into retirement accounts, when to save it up for practice buy-ins and ASC buy-ins, etc. He disclosed at that point that he had decided to buy into the ASC already in between sending me the initial email and the recording of the podcast. He just saw it as too good of an opportunity to miss out on and I agree. Here is how he did it,

“We wanted to pay off our loans aggressively as soon as we could. That’s always been our plan when we came together. I ended up having to get a small business loan with a local
bank here that had worked for the surgery center for years and had financed many of the partners in the past. So I had no difficulty on that end, they were pretty willing to give me the loan. And what we have done, we have turned our attention to just paying off that loan as quickly as possible. I’m just paying the minimum on my student loans now and I’m paying 50% of my base salary goes towards paying off debt and any bonus I get, 75% of that goes towards paying off the extra loans. So I plan this particular loan should be paid off by June, and that point I’ll redirect all my finances back into paying off my student loans.”

The bigger issue coming up now is he won’t have anything set aside for the partnership when that time comes up in another year, so he will have to look at financing probably that $300,000 for the buy-in. But when 50%-plus of your income is going toward retiring debt, you’re on the fast-track to wealth there. The debts will go away very quickly at that rate, and if he keeps saving like that and putting it toward investments, he will be financially independent very very quickly.

As he should, he is looking at the surgery center as an investment. It gets really good returns. It is buying stock in the company. Not particularly diversified, but you know, there are two schools of thought when it comes to investing. The first is diversify broadly to protect yourself from what you don’t know. Don’t put all your eggs in one basket. The second one is to put all your eggs in one basket and watch it very very closely.

I think a surgery center or a free-standing E.R. or these sorts of imaging centers that radiologists might buy or dialysis centers for nephrologists are kind of in that second category. It’s a business that you buy into that you expect better returns than you’re going to get out of stocks or real estate because there is more risk there. But it’s also your
day-to-day life and something you’re keeping very close tabs on. I think it is nice to have a mix in that respect of those two investing philosophies.

**Retiring Doctors**

Dr D felt like it were too good an opportunity to pass up and if he just got his foot in the door, there would be more opportunity to buy more shares later on down the road. Partners are required to sell out once they hit a certain age limit. And in the next five years, two partners will be hitting that age and there’ll be about 10% of the company up for sale. Partners have to start selling 20% every year. So by age 70, they are completely sold out.

The idea behind that was they wanted people who were actually practicing and bringing cases to be the owners. Most surgeons would slow down and they didn’t want people who were not operating getting the largest amount of the profits. Dr. L thought that was pretty forward-thinking because it avoids some of the ethical and law issues that could come up from people who aren’t being productive. It forces them to scale down.

A separate issue for Dr D is there are a lot of non-partners who operate in their ASC and his concern was them leaving the center. In the next couple of years, there will be at least one high-volume surgeon who will be leaving. And there’s no way he could predict how that is going to affect the future returns. He talked to the surgery center owners about that and the plans they have to actually expand and try to bring in new procedures to maybe make up from that revenue loss for the high-volume surgeons who move.

Dr L responded,

“I think that’s another thing that I was kind of alluding to
when I referred to doing things right. I think part of a surgery center to continue to be productive is to look for continued growth and to potentially look for individuals who, at a certain time, might decide to wind down. A surgery center’s success in productivity could easily hinge on one or even two different surgeons who are really high-producers. And if for some reason they retire or they leave then that could definitely have an impact on the overall success of the facility.”

What to Look For in an ASC Buy-In

What should your due diligence be when looking at this type of investment? Here is what Dr D and Dr L suggest knowing and doing:

1. Hire a health care lawyer to look at the contract and review everything.
2. Complication and transfer rates.
3. Patient satisfaction scores and provider satisfaction scores
4. Efficiency (% of on time starts, average turnover between cases)
5. Experience of O.R. staff
6. Anesthesia (who provides it, how long have they been practicing)
7. They should open up all the books, give you all the numbers, the past history, the profits, their expenses. And if they won’t do that it would be a huge red flag and be very wary of buying into a practice like that.
8. Ask about how many partners are there and what percentage of cases are being done by what percentage of providers and how close to retirement are some of those higher producers. That will have an impact on the numbers that you’re looking at in front of you but more
importantly, it’s gonna impact the number that you’re gonna be dealing with one to five years down the line.

We had a longer discussion on who provides anesthesia at their ASCs. For Dr. L their anesthesiologists actually have a lot of say in terms of what types of cases they are allowed to bring to the center. They all have patients’ best interests in mind. They have come up with protocols that they all feel comfortable with, at least initially. He feels also having a medical executive committee that does random case reviews is important because sometimes people will try to push the envelope as to what type of case would be appropriate for that type of setting. If you have individuals who are essentially policing that, it helps prevent issues that could come about that could lead to poor patient outcomes.

For both ASCs the anesthesiologists are employees or contractors but not owners. There is a benefit in having anesthesiologists that aren’t vested in the center because it could lead to riskier situations.

One listener wanted me to ask about whether they would recommend using a consulting firm when starting an ASC to help navigate through the regulations. Dr. L thought if it was surgery center that was being built up from the ground up for the first time, he thought definitely having some guidance would be beneficial. A lot of the times people’s eyes are bigger than they should be and there is a lot of things that you might want to consider or that you don’t always consider initially. Reminding us sometimes the most important thing to know is what you don’t know and you need someone to tell you that.

**Why Invest in an ASC?**

- Financial benefit of being a part of it.
- Having a say in what equipment you buy and use.
- Productivity and better use of time.
Being involved in leadership helps you have a better impact on patient outcomes.

One reason why a lot of emergency docs get involved in these outpatient emergency departments is that then the employees, the staff, the nurses, the x-ray techs, etc. become their employees rather than the hospital employees. So they decide how much they get paid, they decide what their benefits packages are, they decide which ones stay and go. And as a result, the employees are much more responsive to them. They just enjoy having a lot more control over their practice and how their patients are treated that they can’t get at the hospital emergency department. The responsiveness and attitude of the staff make makes a big difference in patient satisfaction. Dr. L said,

“At our surgery center, for example, everyone from the check-in to the post-op nurses, they tend to have this sunny disposition, I’ll say. Part of it is because patient satisfaction score are very important to us. And I think another aspect of it is, at the surgery center at least, the last employee leaves when the last patient walks out the door. People aren’t staring at the clock, waiting for the change of shift so that someone can come in and relieve them. Everyone’s there, every one works together. It’s a small center so everyone is essentially forced to work efficiently and work together and I think creates a more positive
Dr D said,

“Definitely a better experience for the patient. Just from the time that they enter to the exit, it’s probably half in the outpatient center compared to the hospital. We try to make the environment comfortable for them. They don’t feel like they’re waiting in a hospital. The waiting room feels like they’re are in a luxury spa. So we just try to make the whole environment for them just a better experience overall.”

In Network or Out of Network

Dr. L said initially when their surgery center was re-established the management company that took over things, their model was to stay out-of-network as long as possible. The reimbursements tended to be significantly higher. The challenge was although the facility was technically out-of-network, many of the providers were in-network. So at some point, insurance companies (and patients) don’t like that.

“If you have an out-of-network facility with an in-network provider, eventually the insurance company is going to recoup that money some way. At some point there is a law of diminishing returns where if you lose enough of those small cases because those patients are now going to in-network providers and facilities, then the gain of doing the higher acuity cases that are out-of-network doesn’t really make up for things. So staying out-of-network to a point where it makes sense but then eventually going in-network is kind of a necessity for most facilities and practices but it does give you a bit of leverage in terms of re-negotiating whatever in-network rates you agree upon.”
Calculating the Buy-In for Younger Physicians

Neither doctor felt like there was room to negotiate the ASC buy-in. For Dr. D it was a set formula they have used for all the partners since it opened. They take what the profit would be after all your debt and depreciation, and it’s 4.25 times that amount. There was no negotiation of that. It has been done for every partner since they came in and it was set in stone.

Dr. L felt like the profitability of the center is the profitability of the center. It’s just a matter of what the administration felt would be a fair buy-in and his happened to be about a two and a half multiple.

One Third Law

One listener asked, what happens if you don’t meet the one-third law where at least one-third of your cases has to be done at that center. For Dr D. it is not an issue because he does probably 80% of his cases there.

Dr. L said,

“I think although that law exists, I think it’s not easily enforceable. For example, if I do 10 cases in a week, if I don’t feel comfortable bringing a particular patient to the center, then you can’t force an individual to do something they don’t feel comfortable doing. Even if the administration feels it could be done. It’s written down. I think something like that exists for us. I believe our numbers are it’s expected that 80% of your eligible cases should be done at the center but it’s not something that is enforceable.”

It is part of the Stark Law so someone will not buy in but then not contribute to the surgery center. The Stark Law is
basically a healthcare fraud and abuse law that prohibits providers from referring patients for certain designated health services to an entity in which they have a financial relationship. When I asked about getting rid of non-performing partners, Dr L said,

“So on the one side, as a producer, I can’t and I shouldn’t be paid more for bringing more cases compared to an equal share partner who isn’t bringing as many cases. On the opposite side of the spectrum, we can’t necessarily dismiss a provider who isn’t as productive as some of their peers, so to speak. So it’s a little bit of a slippery slope. Unfortunately, non-producers, they’re there and unless they want to leave under good terms you can’t really do much to get them out.”

Disclosure of Ownership

We discussed the legal ramification of operating at surgery center you own and how to disclose that to your patients.

Dr L said at their center they have a list of physician owners on a billboard as patients are signing in. And when patients are doing their pre-registration paperwork, there is a form that they sign that that’s being acknowledged. When he first started going to the center he would also tell his patients that he loves going to this place. Things run efficiently. They have a dedicated O.R. team. All they do is GYN. And that he was a part owner.

For Dr. D they have a list of all the partner’s names when the patients first come in and since the surgery center is connected to their building, most people just assume that they are the owners also. So it has never been an issue.
Ending

I hope this episode was helpful. It’s not a subject I’ve ever covered on the blog in eight years and so I think it will be a great resource for readers and listeners.

Remember if you have questions this is a great community to find the answers. Ask in the WCI Forum or in the WCI Facebook group. Or if you want to have your questions answered on the podcast go record them [here](#)!

Full Transcription

Intro: This is the White Coat Investor Podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high-income professionals stop doing dumb things with their money since 2011. Here’s your host, Dr. Jim Dahle.

WCI: Welcome to White Coat Investor Podcast number 94, Surgery Center Investments. This podcast is sponsored by Alexis Gallati of Gallati Professional Services. Alexis is not your
typical tax advisor. With over 15 years of experience, she’s been helping physicians all over the country save money on their taxes. As the spouse of a busy physician, she understands the burden of high tax payments physicians incur during their lifetime. Not only will she create a high-level strategic tax plan for you, guaranteeing money in your pocket, but Alexis will proactively work with you throughout the year to maintain your tax plan, prepare your annual tax returns, and represent you in case of an audit. The investment in her tax planning services is a fixed-price agreement, and her tax maintenance packages are a flat monthly fee. If you’re tired of complex tax jargon, and giving away most of your paycheck to the IRS, visit Alexis’s website at www.gallatitax.com today to schedule your free initial consultation.

WCI: Our quote of the day today comes from J.L. Collins, who said, “Yes, it is possible for every middle-class wage earner to retire a millionaire, though it’s never going to happen. And that’s not because the numbers don’t work.” I like that quote. I think that is entirely possible, if you can get yourself to a middle-class wage to become a millionaire.

WCI: Today we’ve got a pretty special episode. I’ve got two docs that are going to remain anonymous, but we’re going to talk about outpatient surgical centers as an investment and a place to practice. So let’s get into the interviews.

WCI: All right, we have two special guests on the White Coat Investor Podcast today. We have Dr. L. and Dr. D. Obviously, we’re trying to preserve a little bit of anonymity on this episode, but the real impetus behind this episode was to try to talk about outpatient surgical centers. This is something I get questions on all the time, and given that I’m not even a surgeon, nor have I been involved in one of these businesses, it’s difficult for me to answer those questions, and so I thought I’d at least try to get some people on with some experience to talk about it.
The truth is, there’s very few people who are involved in a lot of these, and it’s hard to find an expert on the topic out there that can really give some specific recommendations, so I thought the best we could do was to get two docs on, one of whom is looking at an opportunity to buy into a surgical center, that’s Dr. D, and one doc who has fairly extensive experience with owning a surgery center, and that is Dr. L. And so the question that I had, or the offer I had to be a podcast guest, originally came from Dr. D, who said, “I’m three months out of residency with moderate student loans, and I’ve just been offered a small percentage in my ASC. I’m also planning on making partner in one to two years with around a $300,000 buy-in. I would like to explore ways to prepare for practice and ASC buy-ins, and how that fits in with paying off debt and saving for retirement.”

Then I put out the question to the e-mail list, you know, 21,000 docs going, “Hey, who’s got experience with ASCs and would like to come on the podcast and talk about them?” and Dr. L was gracious enough to agree to come on, and I think will make for a great guest for this episode. So welcome to both of you, Dr. D. and Dr. L.

Dr. L: Thanks, Jim, for having us here.

Dr. D: Yeah, thank you Jim, and thank you, Dr. L.

Dr. L: No problem.

Okay, so let’s get started in this a little bit. Let’s start with Dr. D. Can you tell us as much as you can, and I know there’s always some details that you’ll want to keep private, but as much as you can about not only your financial life where you are right now with it, but also about the details of this opportunity you’re having presented to you.

Dr. D: Yeah, no problem. I’m actually very blessed to have a very small amount of student loan. I was prior military before I went to my undergrad, so I was able to use a GI bill during
medical school. So after the end of my residency, I had about $90,000 in student loans, and originally me and my wife had planned to aggressively pay that off in one year, and continue that high rate of saving, and save up for my buy-in for my partnership in two years. And at that time it should be a substantial increase in my income, and my plan was just to get a small loan for the rest of the buy-in, and then I would look at any buy-in to the surgery center at that time.

Dr. D: Traditionally you had to be a partner in the practice before you can even buy into the ASC, but I had a very unique opportunity that I wasn’t expecting, that just only five months in. Still, with my student loans, I had an opportunity to buy a very, very small percentage. And the reason is that I got way busier than they originally thought I would be here only after five months And I actually operated two community hospitals, so there’s a little incentive for them to offer me some buy-in to the practice to direct my patients here when it was in their best interest.

Dr. D: We do have—at this time we have my wife’s 401k that we match, that we max out, and I also max out a Roth IRA. That’s kind of where we’re at financially right now. The opportunity of the ASC is we’re a multi specialty center. We’re fairly large. We’re not the only ASC in town but we’re by far the largest one and do the most production and have the highest revenue value.

WCI: And your specialty?

Dr. D: I am an ophthalmologist

WCI: And Dr. L, can you tell us a little bit about your experience as being an OB-GYN and being a part-owner of a surgery center?

Dr. L: Sure. So I started out practice a couple of decades and luckily, and I’m kind of afraid to admit this, but I was able to graduate without any medical school and undergraduate debt.
So right off the bat I was a little bit ahead of the curve so to speak. Initially, I actually had zero interest in getting involved in a surgery center. There was one that my practice was affiliated with and it was actually a physician-run surgery center. And my understanding was they were basically writing checks every month to meet the bills and pay off the loan debts. So it had been in existence for a number of years and for whatever reason they just weren’t as profitable as they potentially could be.

WCI: So it was cash flow negative. They were feeding the beast.

Dr. L: It was cash flow negative. In fact my partners were encouraging me to utilize the center obviously because it benefited them but from my perspective the surgery center was about 30 minutes further from where I lived and if the hospital was a closer commute, why would I waste my time going out there if it didn’t really benefit me in any way. And it wasn’t until I started getting busier in my own practice that I started doing multiple cases that I guess I realized some of the inefficiencies that can exist in a hospital type of setting. So if you have a 15, 20 minute case but you’re having a 30 to 45 minute turnaround time in between cases eventually it seemed a little bit of inefficient use of time, so to speak.

Dr. L: So luckily at the time I started getting busier there was a management company that became interested in the center that my partners owned. And they said, “Hey, you know what? You guys have a lot of providers affiliated with the center. It looks like you’re doing some things but you could be doing a lot of things better. If you let us take the reins, so to speak, we can help get rid of excess baggage and potentially bring in some newer providers who will do different types of cases and, potentially, higher acuity cases. Maybe that could kinda turn things around and hopefully turn out a profit.
Dr. L: And I guess it was by chance that I happened to be getting busier at that time as well as a couple of other providers and we were approached as new talents, so to speak. And they pitched it, in a sense, that hey, we can all become a part of this center, we can work on productivity, we can make it more efficient for everybody, we will get busier and hopefully kinda turn things around.

Dr. L: So initially I was told about a potential buy-in and I actually had no money saved up. I’m not afraid to admit I took about two months off before I started my attending lifestyle and I kinda racked up some credit card debt. And luckily the specifics of the arrangements for the center dragged out long enough where I could save up enough money to buy up my piece of the pie, so to speak. And luckily within that first year, we were receiving checks. We became profitable and things have been heading that way ever since.

WCI: So did the management team buy it from the docs that owned it before or did they just come in, they were hired help, or what was the structure there?

Dr. L: They were a management team and they essentially purchased 30% ownership of the entire center. And the former owners, they were given the option: “Hey–would you like to be part of the new entity? You could get X% for X amount. But if you wanna be released from the current debt, then you can say ‘Bon voyage’ and we’ll leave it at that.”

Dr. L: So luckily there were a number of people that said, “Hey, you know what? I’m at the tail end of my career, I don’t need to be taking any more risks.” And there were some younger docs, involved docs, who said; “Hey, you know what? I think we could do something here. Let’s keep going forward.”

WCI: So did those older docs that bailed out end up losing their shirt given that this had been unprofitable for years and years? Or did they make out okay?
Dr. L: They lost a fair amount of money ’cause they were writing checks every month for about four or five years I’d say.

WCI: Just several thousand dollars every month, huh?

Dr. L: Yeah. But there were enough of them where it was kinda spread out and I guess they’d been doing well enough in their main practices that it wasn’t too much of a burden, so to speak.

WCI: Yeah, kind of a warning there, is that those things don’t always make money though, isn’t there?

Dr. L: Definitely. I think a lesson that I learned just looking at things is I think you can get as much out of any business, whether it’s surgery center or side business, you’ll get as much out of it as you can put in. And if you’re managing a center it does take a fair amount of time to kinda do things right, number one.

Dr. L: Number two, there’s always a more efficient way to do something.

Dr. L: And then number three, you can have any number of providers affiliated with the center, but if no one’s bringing cases there, then that surgery center is basically a really expensive closet for a bunch of expensive equipment.

WCI: You say “do things right.” What do you mean when you say that? Are you talking about ethically which cases get brought and how they get done by who? Or—what do you mean by that?

Dr. L: I think one thing that the group never looked at were things like reimbursement and negotiating contracts with payors. I think that’s one thing. There’s a more efficient way to do that, number one.

Dr. L: Number two, being willing to bring cases to the center. Just because a case could be done at a hospital because it’s
more convenient doesn’t necessarily mean that it’s more beneficial for the center that exists.

Dr. L: So I think, number one, utilizing the center to its fullest ability was something that people had to learn. Realizing that certain types of cases could be done in an outpatient setting is something that took people time to get used to. And once people are able to realize that certain types of surgeries can be done in that type of environment, people start to feel more comfortable with doing those things in that particular setting. And when people are bringing those cases to the center, then the center is being utilized and it becomes more productive.

WCI: Can you talk about there being any pressure or conflicts of interest to maybe bring cases there that are borderline in a gray area? Maybe shouldn’t be brought there at all? Maybe they should be done at a hospital?

Dr. L: I think that was one of the things that was initially challenging for some of the partners because the center evolved at a time where things like laparoscopically and minimally invasive surgery were really being developed. So initially, a lot of these cases, things like hysterectomies and myomectomies, were done in an open manner where patients needed to be admitted to the hospital, usually overnight, sometimes two nights. But then with the advent of newer technology and more refined techniques, a lot of these cases were being done essentially at the hospital laparoscopically or in a minimally invasive way, and patients were basically going home from the hospital. So if you have a skilled group of individuals who are able to do these things in a safe manner, it’s just a matter of changing the setting there they are actually performed.

Dr. L: So definitely there are probably some cases that can be done at a center that shouldn’t be done at a center. But I think when you have a group of talented individuals, not only surgeons but anesthesiologists and an O.R. team, that can do
things safely, it’s just a matter of trying to change the environment where these things are being done.

WCI: Now is the physician fee portion for the surgery about the same no matter where you do it? Was there any difference there for you or is that portion sixes?
Dr. L: The physician fee doesn’t really change whether it’s done in a hospital or a surgery center.

WCI: So it’s just a matter of collecting the profits on the facility fee for surgery then.

Dr. L: Exactly. Exactly

WCI: And can you talk a little bit, as much specifics as you’re willing to get into, about how much it costs you to buy in and what kind of returns you’ve seen on that money?

Dr. L: So I guess the buy-in is really kinda dependent on what type of center is being run. Our center at the time happened to be a single specialty center. GYN only. And, like I said, at the time everyone is writing checks. So they had kinda bare-bones equipment because the type of procedures being done there weren’t necessarily higher acuity cases that are being done now so the equipment was not all that much.

Dr. L: With that said, the area that our center exists, the real estate’s little bit on the higher end of the spectrum, I’d say. Our surgery center I think at the time was about 5,000 square feet and the average square footage was $35 a square foot. So just for the facility itself, you’re talking about up to $200,000 a year just for the rental space.

Dr. L: In terms of equipment, so of those things are kinda pricey. Believe it or not, an O.R. table that’s pretty decent can be anywhere upwards of $25,000 to $30,000. You have to have anesthesia equipment for general anesthetic. That could be anywhere from 40 to 50K. If you’re gonna do laparoscopy or hysteroscopy, video towers could be another 40, 50,000. And
then you have to worry about things like sterilizers, autoclaves, PACU. Those little stretchers that people use, they’re actually kinda pricey. They could be anywhere from $2,000 to $3,000 each. And if you have a four-bed PACU and a four-bed recovery, that kinda adds up.

WCI: Yeah, I know the gurneys in our E.R. cost about six grand so that equipment can sometimes be ridiculously expensive.

WCI: So how much value is there in that equipment? I mean, if you turned around and you needed to sell it if you’re closing the place down, do you get pennies on the dollar? Or what do you get for it?

Dr. L: I think just like a car, once you drive it off the lot it does depreciate significantly. I wouldn’t say pennies on the dollar. Maybe nickles or quarters off the dollar.

WCI: (laughs)

Dr. L: We recently underwent a renovation of our center and it went under a complete facelift. We expanded the O.R.s. And that by itself was about $2,000,000 for the physical structure. You combine that with the equipment putting everything together it could up to $2.5 million if we were to start everything anew.

Dr. L: And that’s just the start-up cost. It doesn’t include staffing, daily operating costs, front house, O.R. techs, management.

WCI: Yeah, there’s a lot of capital there, for sure. And it sounds like, at least in this case, the real estate and the business are all blended in together, correct?
Dr. L: Yes.

WCI: And do you have any idea what kind of returns you’ve seen on that? Has it been in the 20% range? Or better? Worse? What do you think it’s been over the years?
Dr. L: Well from when I got in the valuation of the company was significantly less but within that first year based on my buy-in, I got about a 200% return on my investment. And then for the subsequent eight years, as we became a little bit larger, a little bit busier, and people actually felt comfortable bringing cases to the center, we were seeing upwards of anywhere from a 400 to 500% return on the investment over that time.

WCI: On your initial investment or over the previous year’s value?

Dr. L: On my initial investment.

WCI: Okay. Very nice. So it’s been very very good for your finances to be a part of this surgery center then, it sounds like.

Dr. L: It’s been good, it’s been good.

WCI: So Dr. D, do you have any idea, have they given you any information on how the business is done in the past and what you can kind of expect going forward on this?

Dr. D: Yes, sir. Now I will say mine is quite a bit different than Dr. L’s. The surgery center is attached to my main building. So it’s literally 15 steps from my clinic lines to the surgery. So I can operate, come back and see a patient, and then go back and do another case if I need to. It’s all in the same building, but the buy-in to the practice does not count the real estate. That’s a totally different LLC. And the same for my practice, so the founding partners own the real estate and then of course we pay rent to both of them. So then the buy-in does not include the actual physical building.

Dr. D: And in ophthalmology, almost all surgeries are done in outpatient centers. There are very few done in a hospital. Now the only reason I operate in a hospital is clearly due to convenience to my patients because my satellite clinics are
about an hour and a half away and it’s just a long drive to bring them all the way back to our main clinic. And like Dr. L said, one of the biggest advantages is just efficiency. I literally operate in one room, go to the next room, operate, come back out, scrub, operate again, where in the hospital there’s a 20, 30 minute turnaround time. And we have much more stronger negotiating power with the equipment, like the intraocular lenses. We get them for a much cheaper price because we do such a high volume here compared to the surgery center.

Dr. D: But that one percent share in the current surgery center I’m in is about $240,000. I’ve been offered only a fifth of that share, so I’m not even offered a full share. Which is good because there’s no way I could afford $240,000, one percent buy-in at this point right now.

Dr. D: And that’s really why I was taken back being offered it this soon and didn’t really know what to do with this situation. I think in the ophthalmology side most surgery centers are pretty profitable just because we do such a high volume of surgery and it’s been a long track record of having outpatient centers. And this particular center has been here for close to 20 years. I wanna say the profits per year is just a little under eight figures, so it’s been a profitable center.

Dr. D: The ideal is that your original investment will be paid back in 4 and a quarter years. That’s the ideal. So a $240,000 should be paid back in 4 and a quarter years and after that anything you make should be just profit on the original investment.

WCI: Yeah, I mean at those sorts of returns it makes sense to borrow money for your share. As much as they’re willing to sell you, you wanna buy, just because the returns are spectacular at that sort of rates.

Dr. D: And that’s how I felt, Jim. I felt like I really did
not want to get more in debt with my student loans. But I felt like it were too good an opportunity. And if I just got my foot in the door, there’d be more opportunity to buy more later on down the road. Because partners are required to sell out once they hit a certain age limit. And in the next five years, two partners will be hitting that age and there’ll be about 10% of the company will be up for sale. So I just wanna get my foot in the door so I can have that opportunity in the future to buy into some more.

Dr. L: That’s interesting that you actually mention that the partners are required to sell out after a certain age point.

Dr. D: What’s been your experience for that, Dr. L?

Dr. L: That’s actually a work in progress.

Dr. D: (laughs)

Dr. L: I haven’t had any partners that have officially retired as of yet. There are people that are considering it. Probably some partners we’d like them to consider sooner rather than later.

Dr. D: (laughs)

Dr. D: At age 65, you got to start selling 20% every year. So by age 70, you’re completely sold out

Dr. L: Wow.

WCI: And what was the reasoning behind doing that? Just because you wanted people who were actually practicing and bringing cases to be the owners? Was that the idea behind it?

Dr. D: Absolutely. Most surgeons would slow down and you didn’t want people who were not operating getting the largest amount of the profits.

Dr. L: That’s some pretty forward thinking, actually, because
it actually also avoids some of the, I guess, the ethical and law issues that could come up from people who aren’t being productive. It kinda forces them to kinda scale down, so to speak. So that was very forward thinking of those partners.

WCI: Now it doesn’t sound like your buy-in is gonna be a huge chunk of money, but tell us a little bit about what you thought about and your mindset. You know, you’re just out of residency, don’t have much in debt in your case. Lots of surgeons in your situation might owe $300,000 or $400,000 in student loans. What was your thought process in deciding when to pay off student loans, when to put it into retirement accounts, when to save it up for practice buy-ins and ASC buy-ins, etc?

Dr. D: That’s funny you said that, Jim. I do have very little student debt. When I met my wife, her mouth pretty much hit the floor, her jaw did, when I told her how much debt I have. So it’s still a lot of debt but for the medical world it is a very small amount. And since I sent you that email, I’m actually a partner now. I did go ahead and buy into the practice.

Dr. L: Congratulations.

Dr. D: Thank you.

Dr. D: I just saw too good an opportunity to miss out. And how I did that was we wanted to pay off our loans aggressively as soon as we could. That’s always been our plan when we came together. I ended up having to get a small business loan with a local bank here that had worked for the surgery center for years and had financed many of the partners in the past. So I had no difficulty on that end, they were pretty willing to give me the loan. And what we had done, we had turned our attention to just paying off that loan as quickly as possible. I’m just paying the minimum on my student loans now and I’m paying 50% of my base salary goes towards paying off debt and
any bonus I get, 75% of that goes towards paying off the extra loans. So I plan on being—this particular loan should be paid off by June, and that point I’ll redirect all my finances back into paying off my student loans.

Dr. D: The big issue coming up to me again is I won’t have anything set up for the partnership when that time comes in another year, so I’ll have to look at financing probably that $300,000 for the buy-in for that. Which I was hoping to have a good chunk of that saved, and I won’t have that now that I bought into the surgery center.

WCI: Still, when 50%-plus of your income is going toward retiring debt, I mean you’re on the fast-track to wealth there. The debts’ll go away very quickly at that rate, and if you keep saving like that and putting it toward investments, you’ll be financially independent very very quickly.

WCI: So congratulations on being that disciplined. I think most docs are not.

Dr. D: And I will say I look at the surgery center as an investment. That’s how I approached this. I may not put into the 401k, but I feel that buying into it is the same. Got real good returns on that. And it’s buying stock in the company is what I’m doing. So that’s how I looked at it as far as the investment and paying off debt section.

WCI: Yeah, it’s obviously not particularly diversified…

Dr. D: No.

WCI: But you know, there’s kinda two schools of thought when it comes to investing. The first is diversify broadly to protect yourself from what you don’t know. You know, don’t put all your eggs in one basket. The second one is put all your eggs in one basket and watch it very very closely.

WCI: And I think a surgery center or a free-standing E.R. or these sorts of imaging centers that radiologists might buy or
dialysis centers for nephrologists are kind of in that second category. It’s a business that you buy into that you expect better returns than you’re gonna get outta stocks or real estate because there’s more risk there. But it’s also your day-to-day life and something you’re keeping very close tabs on and so I think it’s nice to have a mix in that respect of those two investing philosophies.

Dr. D: I will say one thing. Dr. L, maybe you could comment on this. There’s a lot of non-partners who operate here and my concern was we’re gonna be leaving in the next couple of years and there was at least one high-volume surgeon who will be leaving. And there’s no way I could predict how that is gonna affect the future returns. I did talk to the surgery center essentially about that and the plans we have to actually expand and try to bring in new procedures. I think this year you can start doing diagnostic caths in ASCs and that’s something we’re trying to bring in to maybe make up from that revenue loss we’re gonna lose from the high-volume surgeons who’re moving to a different town.

Dr. L: In terms of answering the question. I think that’s another thing that was kind of alluding to when I said—referring to doing things right. I think part of a surgery center to be—continue to be productive is to look for continued growth and to potentially look for individuals who, at a certain time, might decide to wind down, so to speak. A surgery center’s success in productivity could easily hinge on one or even two different surgeons who are really high-producers. And if for some reason they retire, they leave, or god forbid, something happens, then that could definitely have an impact on the overall success of the facility.

WCI: So what advice would each of you have for somebody that’s been presented this opportunity. I mean, what should they do to decide whether this is worthwhile? What kind of vetting should take place? What should their due diligence involve? Let’s start with you, Dr. D, and then Dr. L.
Dr. D: One thing I did not do that I probably should do is hire a health care lawyer to look at the contract and review everything. I did not do that. I reviewed everything myself. I had a lot of trust in the partnership. I talked to previous people who’ve been offered partner who recently bought in, got their take on field stuff so I felt comfortable going in doing that without having a contract lawyer. But I would recommend most people probably would need to get a contract lawyer to look at the buy-in and to the ASC. There is actually a company out there who’s willing to evaluate the company for you, to look at the numbers for you and give you feedback on that. I did not feel like I needed it in this particular case. In ophthalmology, ASCs are pretty much a part of a private practice and you don’t really get taught this in residency but I think that’s something you should be planning from Day One. And our specialty is being a part of an ASC and planning your finances ahead of how you wanna approach that when that time comes.

WCI: All right. Dr. L?

Dr. L: I think anyone that’s looking at investing in an existing center, I think their concerns might be different than someone who’s potentially building one up for the first time.

WCI: Mm-hmm (affirmative)

Dr. L: So if you’re looking at a center that’s already been in existence for X number of years, I think definitely questions you might wanna ask if they don’t present it in their original pitch is, things like complication rates—do they seem like they’re above national averages or within acceptable ranges? Do they have access to their transfer rates, for example—if there’s a complication, how many patients are transferred to a hospital from that surgery center? And also, do they look at things like patient satisfaction scores and even provider satisfaction scores—how often do they address those things and
how do they collect that information. Efficiency perspective, and I don’t know if everyone keeps this information but I think it would be good to have. The percentage of on-time starts I think is important. The average turnover in between cases. How long the O.R. staff has been there and what is their experience with the type of cases being done.

Dr. L: And I think another thing that’s pretty important is who provides anesthesia. Are the anesthesiologists there locum tenens and potentially you have a different provider there every week? Is it a set number of anesthesiologists that rotate in and out on a daily basis? How long have these providers been practicing in surgery center settings? Because I’d say the level of anesthesia and the type of anesthesia is sometimes different when you’re in a hospital and you know you have the backup ancillary services readily available than when you’re practicing in a surgery center.

Dr. L: Our anesthesiologists actually have a lot of say in terms of what types of cases we’re allowed to bring to the center. And if they feel, for whatever reason, a particular patient or a particular case isn’t appropriate, we value their opinion. We’re not here to put anyone in a position they don’t feel comfortable with. And vice versa. Because in the end, we all gotta try to do what’s best for the patient.

WCI: So do you have a lot of–do you find there’s a lot of conflict there? That the anesthesiologists are saying “no way” and does that change if they’re also owners of the surgical center?

Dr. L: We all have the patient’s best interests in mind. We’ve come up with protocols that we all feel comfortable with, at least initially. For example, we have a top BMI that we’re willing to even consider bringing into the surgery center and if it’s somewhat borderline we have patients literally meet with the anesthesiologist. And a BMI is just one factor. Part of it depends on whether that body mass is focused. If it
happens to be all in the neck, then that’s an anesthetic risk. And medical comorbidities, level of hemoglobin and hematocrit. As much as we wanna try to do as much as possible at the center, we wanna do what’s safest for the patients. So we have sets of checks and balances.

Dr. L: And I think also having a medical executive committee that does random case reviews, I think that’s important because sometimes people will try to push the envelope as to what type of case would be appropriate for that type of setting. And if you have individuals who are essentially policing that, it kinda help prevent issues that could come about that could lead to poor patient outcomes.

WCI: Now in both of your cases, are your anesthesiologists or CRNAs owners of the center or are they employed staff?

Dr. D: They are only employees at our ASC. We have one full-time anesthesiologist and four or five full-time CRNAs and two locums who come in on a regular basis that fill in any gaps. And I will say for ophthalmology, 95% of what we do is elective so anytime an anesthesiologist has any question or any concern about something we usually just cancel the case. But we do a lot of local or topical anesthesia for our cases so a little bit different environment than we have at our surgery center.

Dr. D: Of course we do GI and urology. But I’d say pretty much, for the most part, we listen to the anesthesiologist and any concerns they have when they voice them.

WCI: Same question to you, Dr. L. Your anesthesiologists?

Dr. L: The anesthesiologists we have at our center are contracted anesthesiologists. Our situation is unique in that they also are the same anesthesiologists that work at our hospital. So we’ve already kind of established a level of trust, I’ll say, and mutual respect. If they have any questions about things that we’re thinking about, they will
freely voice their opinions. And whenever there’s a question it’s easier to say “Hey, you know what–let’s just do this one at the hospital” and no one’s gonna say no.

Dr. L: So I think there’s a benefit in having anesthesiologists that aren’t vested in the center because I think when there’s a little bit too much of that sometimes it could lead to riskier situations.

WCI: All right, let’s get into some of these questions I picked up from the White Coat Investor Facebook group. They’ve got lots of questions for you guys for this podcast.

WCI: Let’s start with the beginning, of someone coming in and buying in. Would you recommend using a consulting firm? And I think maybe they’re even talking about starting one on their own rather just buying into an existing one. Would you use a consulting firm to help navigate through the regulations?

Dr. L: I think if it was a surgery center that was being built up from the ground up for the first time, I think definitely having some guidance would be beneficial. Because a lot of the times people’s eyes are bigger than they should be and there’s actually a lot involved, a lot of things that you might want to consider or that you don’t always consider initially. And there’s different factors that you gotta kinda take into account that you might not realize. I think one thing that’s important is sometimes the most important thing to know is what you don’t know.

WCI: Hmm. Right.

Dr. L: And sometimes you need someone to tell you that.

WCI: Yeah, that’s a good point.

WCI: Another question was: What is their why? Why did you want to get involved in an outpatient surgical center? You wanna start Dr. D, and then Dr. L on that one.
Dr. D: So like I said, all ophthalmologists operate in an outpatient surgery center. The why is just the financial benefit at being a part of it. And also having a say in the type of equipment that you buy and the type of lens that you use. So you’re already gonna operate there, you’re making somebody else some money, why not make it for yourself and then having a say in what’s going on in the surgery center that you gonna be operating in.

WCI: Dr. L?

Dr. L: I think for me the why was more initially had to do with the productivity and the better use of my time. Initially, I was an employed provider and if I’m spending two, three, four hours in the hospital waiting to do two small cases, then that’s time I’m not in the office seeing patients. So rather than being an asset to the group, someone who’s being productive, I’m more of a liability. So as I became busier as a surgeon and I started getting referrals, I had to have a place where I could do things efficiently, where I could do a high number of cases, and I could prove myself as an asset to the group I was a part of. And if I can benefit from that financially, that was icing on the cake, so to speak.

Dr. L: And I think being involved in the leadership of the center, I didn’t realize how much I would, number one, enjoy that, but then, number two, I didn’t realize how much of a better impact I can have on my patient outcomes. I’m really looking at things from both sides of the spectrum, so to speak.

WCI: Yeah, I think that’s one reason why a lot of emergency docs get involved in these outpatient emergency departments, basically, these free-standing E.R.s., is because then the employees, the staff, the nurses, the x-ray techs, etc. become their employees rather than the hospital employees. So they decide how much they get paid, they decide what their benefits
packages are, they decide which ones stay and go. And as a result, the employees are much more responsive to them. And so they just enjoy having a lot more control over their practice and how their patients are treated that they just can’t get at the hospital emergency department. Have either of you experienced that and enjoyed that aspect of it.

Dr. L: I think that’s a really dramatic and very profound comment. I’ve had patients that have had procedures done at the hospital and I’ve had patients that have had procedures done at the surgery center. And when the patients can tell the difference in the staff because of their disposition and their outlook on things. I think that speaks volumes.

Dr. L: At our surgery center, for example, everyone from the check-in to the post-op nurses, they tend to have this sunny disposition, I’ll say. Part of it is because patient satisfaction score is very important to us. And I think another aspect of it is, at the surgery center at least, the last employee leaves when the last patient walks out the door. People aren’t staring at the clock, waiting for the change of shift, they’re not looking at the lunch waiting for lunch so that someone can come in and relieve them. Everyone’s there, everyone works together. It’s a small center so everyone is essentially forced to work efficiently and work together and I think creates a more positive environment and safer experience for the patients.

Dr. D: Definitely a better experience for the patient. Just the time from the door that they enter to the exit, it’s probably half in the outpatient center compared to the hospital. And like the whole experience form the time they’re there, we try to make an environment that’s comfortable for them. They don’t feel like they’re waiting in a hospital. The waiting room feels like they’re more in like they’re in a luxury spa. So we just try to make the whole environment for them just a better experience overall. And the door that they enter and they exit is probably the biggest thing that is
better for the patient. The time they’re waiting and stuff.

WCI: I have a couple of questions related to capital. For example, Alex asked us on the Facebook group asks: “How much capital is generally necessary to get involved in such an investment?” And Mark Singer asks how to secure funding for such endeavors and ballpark costs setting it up and running it. Can you give us some idea if you’re gonna build and buy this thing and start at the ground up and build an outpatient surgical center, how much money are we talking about and where does that money come from?

Dr. L: I’m aware of some individuals in the area that have tried to set up their smaller surgery centers as well and I think one variable that’s regional is the real estate. I think the more fixed costs are the equipment ‘cause those are more national types of costs. And depending on the specialty of the center that also impacts the type of equipment you’re gonna use. I think if you have a lot of orthopedists and neurosurgeons, I know a lot of their equipment and hardware is a little bit pricier than suction D&C set of instruments that the GYNs are gonna use.

Dr. L: We initially were a single specialty GYN and our start-up costs just for the equipment upwards of $200,000 to $300,000. Our real estate, the physical shell, upwards of $200,000. And depending on how much you want to make your surgery center look as much like a spa, the facelift costs could be significant.

Dr. L: For ours, it was approximately a $2,000,000 renovation. So adding that all together, that’s two and a half, $2.6 million for a single specialty.

Dr. L: Since we’ve been in practice, we’ve introduced other specialties, general surgery and Uro-GYN and urology. And luckily a lot of instruments that they use are similar to what we already had so it was a little bit of an easier
integration. But I think as other specialties are introduced and their equipment needs change, then costs are generally gonna go up.

WCI: And that money is just usually borrowed for the most part? Or contributed by partners, part of it and borrowed from a small business loan from a bank? Or where’s the capital typically come from?

Dr. L: We did have a small business loan that we applied for and the rates might be different than what they were ten years ago. I believe at the time when we first did the original renovation I believe our rate anywhere from 5 to 6%. But it was a variable rate so that did change with time.

WCI: And did all the partners have to sign for the loan personally?

Dr. L: All of the partners individually had to sign for the loan to guarantee it, yes, that’s correct.

WCI: Yeah, I bet that felt like a big step doing that.

Dr. L: My heart rate went up a little bit when I signed that note.

WCI: Yeah, I bet.

WCI: Question from Olofunsho Adamolokun, I hope I pronounced that right. He’s asking are you going in-network with insurance companies, staying out-of-network, or a mixture of both?

Dr. L: Dr. D, you got some insight in that?

Dr. D: I’ll be honest, I’m pretty ignorant over it. We set up pretty much every insurance around here. But I’m really ignorant on the details of what we do actually.

Dr. L: So initially when our surgery center was re-
established, I’ll say back ten years ago, the management company that took over things, so to speak, their model was to stay out-of-network as long as possible. The reimbursements tended to be significantly higher. The challenge was although the facility was technically out-of-network, many of the providers were in-network. So at some point, insurance companies, they don’t like that, so to speak.

WCI: Now their patients definitely don’t like it.

Dr. L: Yeah, patients out of pocket costs were significant and if you have an out-of-network facility with an in-network provider, eventually the insurance company’s gonna recoup that money some way, form, or another. So at some point, there’s a law of diminishing returns where if you lose enough of those small cases because those patients are now going to in-network providers and facilities, then the gain of doing the higher acuity cases that are out-of-network don’t really make up for things. So staying out-of-network to a point where it makes sense but then eventually going in-network is kind of a necessity for most facilities and practices but it does give you a bit of leverage in terms of re-negotiating whatever in-network rates you agree upon.

WCI: Hmm.

WCI: Let’s switch to another question. Three good questions, actually, from Vencata Boravula from the Facebook group, who asks “How do you calculate the buy-in for younger physicians and is there room to negotiate.”

Dr. D: I’ll say from my experience, there was no room to negotiate. It’s a set formula they have used for all the partners since it’s been open. And it’s basically they take up what the profit would be after all your debt, after all your depreciation, and it’s 4.2 times 5 that amount. So like I said the ideal of my original investment should pay for itself in 4.25 years. But there was no negotiation of that. That’s something’s been done for every partner since they came in and it was set in stone.
WCI: And how do you negotiate that, Dr. L? Or how do you calculate the buy-in?

Dr. L: I’d have to agree with the same thing. It’s kinda straightforward. The profitability of the center is the profitability of the center. It’s just a matter of what the administration felt would be a fair buy-in wanted to come in and ours happens to be about a two and a half multiple.

WCI: So he also asks; “What happens if you don’t meet the one-third law?” I don’t know what the one-third law is. Do either of you know what the one-third law is?

Dr. D: Yeah, at least one-third of your cases has to be done at that center—

WCI: Okay.

Dr. D: —which is not an issue for me, ’cause I do probably 80% of my cases there.

Dr. L: I think although that law exists, I think it’s not easily enforceable, so to speak. For example, if I do 10 cases, for example, in a week, if I don’t feel comfortable bringing a particular patient to the center, then you can’t force an individual to do something they don’t feel comfortable doing. Even if the administration feel it could be done. It’s written down. I think something like that exists for us. I believe our numbers are it’s expected that 80% of your eligible cases should be done at the center but it’s not something that’ enforceable, so to speak.

WCI: I see.

Dr. D: I think that’s part of the Stark Law, I believe and it’s to protect you from your investment that somebody won’t buy in but not do any surgery, not contribute to the surgery center. I believe that’s the reason behind that law.

WCI: What will be the process for getting rid of non-
performing partners?

Dr. L: That’s another slippery slope as well. Like Dr. D was mentioning that kinda relates to the Stark Law as well. So for those not familiar, the Stark Law is basically a healthcare fraud and abuse law that prohibits providers from referring patients for certain designated health services to an entity in which they have a financial relationship. So on the one side, as a producer, I can’t and I shouldn’t be paid more for bringing more cases compared to an equal share partner who isn’t bringing as many cases. On the opposite side of the spectrum, we can’t necessarily dismiss a provider who isn’t as productive as some of their peers, so to speak. So it’s a little bit of a slippery slope. Unfortunately, non-producers, they’re there and unless they want to leave under good terms you can’t really do much to get them out.

WCI: So another question from Dusty Schuett in the Facebook group: “What are the legal ramifications of operating at a surgery center you own and what disclosures are required to patients and maybe more importantly, how do you bring up that you own the place where you will be operating on them, to patients?” Is that tricky conversation or is that just kind of an expected thing? Or have you run into any issues with that?

Dr. L: Again, that kinda has to deal with the Stark Laws as well. At our center, for example, we actually have a list of all the physician owners. It’s essentially a billboard as they’re signing in. And when patients are doing their pre-registration paperwork, again there’s a form that they sign that that’s being acknowledged.

Dr. L: Initially when I first started going to the center, I would tell patients hey I love going to this place. Things run efficiently. We have a dedicated O.R. team. All they do is GYN. They’re not doing a knee case in one room and then two hours later doing a craniotomy in another room. So that provided them with a level of comfort I would say. But
definitely, it does need to be disclosed. Again, that’s part of the Stark Law as well.

Dr. D: Yeah, we too. We have a list of all the partners’ names when they first came in. But in ophthalmology, like I said, we don’t do much operating in the hospital so it’s not an issue. And since our surgery center is connected to our building, most people just assume that we’re the owners also. So it’s never really been an issue for us.

WCI: Question from Nittan Sastree who asks: “Any experience with turning an office space surgery suite into a one-bed Medicare-credentialed ASC?” Sounds like kind of a play to try to get more money for doing a procedure in an ASC rather than the office. You have any insight into that?

Dr. D: Negative. I know there’s a movement to do office-based cataract surgery but I think it’s died down in the last couple of years.

WCI: Is that just because you can’t get paid the same for doing it there? Is that the issue?

Dr. D: I honestly don’t. I’m ignorant on that.

Dr. L: Yeah, I don’t have any experience converting an in-office suite to a Medicaid-suite per se. Or one that provides that type of service. But there are many GYNs that do have in-office suites but they’re not necessarily designed as an ASC so, as such, they can perform the procedures there but can’t necessarily collect the facility fee.

WCI: Here’s a question from Mark: “What do they do with their complications? Are they required to have admitting privileges to an inpatient facility?”

Dr. L: So I’m not sure with ophthalmologists how many emergent cases need to be transferred but definitely with GYN that can happen. That can be an issue. So all of our providers that provide surgical services at our center need to have admitting
privileges at one of the hospitals that’s within a 20 to 30 minute radius of the center. There has been occasions where patients had needed to be transferred for observation, fluid management issues, even issues with blood loss. So luckily it’s rare but I’m gonna say it doesn’t happen.

WCI: How about this question from Daniel Faruzia who asked about certificates of need. Are you in states where a certificate of need is required to open an outpatient surgical center? Is that an issue? Or not really?

Dr. L: So in Maryland it is one of those states that does require a certificate of need, particularly if you’re gonna open up a two O.R. suite. I believe if it’s one main O.R. then a certificate of need is not required. But if you were to open up a double O.R., so to speak, then a certificate of need is needed.

WCI: And Dr. D?

Dr. D: We are a C.O.N. but I really don’t know how that plays into the logistics or administration of it. WCI: Yeah, I don’t know either nor do I know whether an outpatient surgical center is more profitable when there are certificate of need state versus other states. Good question. None of us know the answer, doesn’t sound like.

Dr. D: (laughs)

Dr. L: (laughs)

WCI: Here’s another one, from Kapil Saigal: “Are there non-compete terms and duration and is there relative likelihood there will be a capital call for the partners if the center loses surgeons or money?”

Dr. D: That’s a good question. That’s one of the fears I have ’cause I’ve only been here five months and a good number of physicians don’t stay in their original location so my
original thought I’d be here two years I’d know for sure if I’d wanted to stay here in this area. So but for me, if I decide to leave on good terms, the practice will buy back my initial investment at the same multiplier as when I bought in.

Dr. L: I think part of that fear is if you have a group of individuals at a particular center that happen to be the producers of that center is to protect the main entity from having those individuals leave and set up another center across the street. Our center in particular does have both a non-compete, it’s two years and 25 miles. That’s what we kinda put into place at our particular facility. And in regards to the second part of that question, yes capital calls can happen and unfortunately, the history of the center that I’m with it sounded like it happened on a regular basis.

WCI: Yeah, sounds like it happened every month at that center.

WCI: Okay, let’s go over the last question here, we’re starting to run out of time. But this question is interesting: “What are your thoughts on forming the surgery center as a non-profit” asks Andrew Takamori from the Facebook group, with the idea being the owners still get high salaries rather than ownership distributions, profit distributions. Have you heard of any centers that do that and is that a reasonable option or not really?

Dr. L: I think if I brought that up to some of my partners or our legal counsel I think that might suggest that that proposal might not pass Maryland’s sniff test.

WCI: (laughs)

Dr. L: That’s just my opinion.

Dr. D: I don’t know what the financial advantage to doing it would be anyway.

WCI: I think the idea here and I have no idea if this is possible or not. I think the idea is to get better tax
situation for the business and yet pay a whole bunch out in salaries and so the doctor owner still makes a lot and also enjoys the benefit of being a non-profit. I think that’s where they’re going with it. Again I have no idea if anybody’s doing that or how that works…

Dr. L: I think the challenge might be also if you’re gonna provide a salary it’s gotta be market rate. So if you’re simply an owner, you have to have a role or a title and there’s a way to figure out the market rate for that. If you’re just an owner and you’re giving yourself a salary of a quarter million dollars for no particular reason, then that’s an arbitrary number then. Again that might be a little bit of a challenge, and a stretch.

WCI: Yeah, I think you’re probably right.

WCI: All right, let’s just do one last question and give it to both of you in turn. We’ll start with Dr. D. “What else would you want people to know before they got involved in an outpatient surgical center that we haven’t yet covered?”

Dr. D: I think the most important thing would be, and we kinda covered it. If somebody’s not open with you, to looking at the books and being very upfront with you, then that would be a very big red flag to me. They should be willing to open up all the books, give you all the numbers, the past history, the profits, their expenses. And if they won’t do that I think that would be a huge red flag and I’d be very wary of buying into a practice like that.

Dr. L: I definitely agree with that. And I think another thing to definitely ask and know about is how many partners are there and what percentage of cases are being done by what percentage of providers. And I guess how close to retirement are some of those higher producers, because that will have an impact on the numbers that you’re looking at in front of you but more importantly it’s gonna impact the number that you’re
gonna be dealing with one, two, three, four, five years down the line. ‘Cause like I said earlier, it’s very easily that one or two providers can bring a great majority of a center’s productivity.

WCI: Dr. D and Dr. L, thank you so much for coming onto the White Coat Investor podcast today. I think this will be really helpful for people who listen to it. It’s not a subject I’ve ever covered on the blog in eight years and so I think this is gonna be a great resource for them. And thank you very much for volunteering your expertise and your time and your experiences.

Dr. L: Jim, Dr. D., it was an awesome experience. Thanks for having me here. I appreciate it.

Dr. D: Yeah, thank you, gentlemen.

WCI: That was great. I really those docs coming on. That is a topic I’ve wanted to hit on blog or the podcast for a long, long time. And I’m constantly asked about it and just don’t seem to have the expertise personally to talk about it, so it was great to get some personal experiences.

WCI: This episode was sponsored by Alexis Gallati of Gallati Professional Services. Alexis is not your typical tax advisor. With over 15 years of experience, she’s been helping physicians all over the country save money on their taxes. As the spouse of a busy physician, she understands the burden of high tax payments physicians incur during their lifetime. Not only will she create a high-level strategic tax plan for you, guaranteeing money in your pocket, but Alexis will proactively work with you throughout the year to maintain your tax plan, prepare your annual tax returns, and represent you in case of an audit. The investment in her tax planning services is a fixed-price agreement, and her tax maintenance packages are a flat monthly fee. If you’re tired of complex tax jargon, and giving away most of your paycheck to the IRS, visit Alexis’s

WCI: You guys ask me about this all the time in emails. You want someone to help you with your tax strategizing, your tax preparation? I finally got an awesome person to refer to you. I think I’ve only got two or three or maybe four of these folks so far in years of looking for great tax people that know the physician situations in and out. Here’s one of them. Give her a call. gallatitax.com and get that free initial consultation.

WCI: Be sure to check out what we’ve got over at the website. If you haven’t signed up for the newsletter, make sure you’ve done that. That gets you the Financial Bootcamp emails. And in fact, in just another week or two, we’re gonna have the White Coat Investors Financial Bootcamp book out so watch for that and should be able to pick it up at a reasonable price and enjoy that and get your finances in line.

WCI: Head up, shoulders back, you’ve got this. The entire White Coat Investor community is behind you, and we’ll see you next time on the White Coat Investor podcast

Disclaimer: My dad, your host, Dr. Dahle, is a practicing emergency physician, blogger, author, and podcaster. He’s not a licensed accountant, attorney, or financial advisor, so this podcast is for you own entertainment and information only and should not be considered official personalized financial advice.
Our Alternative and Real Estate Investments

Most of my portfolio is pretty boring. 60% of it is invested in stock index funds and 20% of it in low-cost bond funds. That never really changes, so there is little point in writing frequently about it. However, about twice a year I update readers on my other investments. This 20% is primarily invested in real estate investments, but the main aims of this portion of my portfolio is high returns, low correlation with stocks and bonds, and getting paid for illiquidity. Many of these investments are not available to you, but there are often similar investments that are if you are interested. Bear in mind all of these are completely optional. If your written investment plan avoids them completely, you are probably going to be just fine so long as you fund the plan adequately. Returns discussed in the post are as of February 11th, 2019.

The Vanguard REIT Index Fund

My investing policy statement dictates 5% of my portfolio be invested in this fund. I’ve owned it since November 2006. My annualized dollar-weighted returns since that time are 7.76%, dragged down significantly by 2018 when it returned -7.63%. It
is up almost 13% already in 2019. Remember that with dollar-weighted returns, in a portfolio that is rapidly increasing in size, recent returns have a much larger influence on the annualized returns than you might expect. I’m a little underweight here right now, with only 3.24% of my portfolio invested here, so that probably worked out in my favor in 2018 and against me last month.

**Peer to Peer Loans**

Remember these? I added these to my portfolio back in 2011 and exited (or rather, started exiting) in late 2016. I used primarily Lending Club but also Prosper. They actually treated me quite well.

- 2012: 12.65%
- 2013: 13.16%
- 2014: 11.34%
- 2015: 9.99%
- 2016: 7.09%

I decided I wanted out because I didn’t like the very concentrated platform risk and it seemed silly to be taking that kind of risk for 8-10% returns when I could invest in hard money loans backed by a forecloseable property instead. It turned out to be far more illiquid at that point than it had been years earlier when I started investing in this asset class. Nevertheless, I was able to liquidate 90%+ of it within a few months and invest it elsewhere as planned. But I still have money there that I won’t see for years. That’s not such a huge deal in my Prosper account. It was never more than a small taxable account, but just before I decided to get out, Prosper decided they weren’t going to let you sell your notes on a third party platform. So as they are paid off, I periodically transfer the money to my checking account. I currently have $107.23 in that account spread across 11 current notes and one late note. I won’t get my last dime back

The Lending Club account was more problematic. I also had a small taxable account there that actually liquidated pretty quickly. But the larger Roth IRA account was a lot harder to liquidate. I sold very few at a premium, a bunch at par, and even more at a small discount. It became obvious I wasn’t going to sell any more unless I was going to give them away, so I decided to just keep trying to sell them at par and wait for them to mature. There were two problems with this approach. The first is that to move cash out of the account requires an IRA rollover, which is a pain and comes with a $25 fee. The second was that once my balance fell below $5K, the self-directed IRA holding the assets started charging a $100 annual fee that had previously been waived/paid by Lending Club. Despite having all of my notes for sale for nearly all of the last two years, I still own 52 current ones and seven late ones, for a total of $1273.74. A $100 annual fee on a $2000 account is the equivalent of a 5% ER, so needless to say my returns the last two years have not been stellar (-5.22% in 2017 when I was selling a lot at a discount and -1.60% in 2018 when I wasn’t), but at least they’ve only been on a relatively small amount of assets. Most of the money was moved out within just a few months. I’m still trying to sell those last 59 notes, but if I can’t, I’m stuck here until October 2021 too. My overall Lending Club annualized return was not bad, 7.96%.
Partnership Office Building

I still own part of my partnership office building. The value is only assessed once a year, so no real change here. The tenant is great! The return has ranged from excellent to poor over the years. Last year it was poor due to a bunch of upgrades. 9.25% annualized overall.

Indianapolis Apartment Building

This was the one bought through RealtyMogul in 2014. It got behind on payments for a while but caught up. Over the years it has sent me $2,030 on my $10,000 investment. The next distribution is due later this month. It was targeting a 7-12% cash on cash return (and a 15% IRR). I’ve seen 4.89%. I should have a payment hit about the time this is published. They tell me the cash on cash return has been 5%, which is about right. The estimated hold was 5-7 years, so we’ll see what the overall return is in another year or two.

My Local Grocery Store

I no longer own my local grocery store. As discussed in this post, this RealtyShares investment went round trip. It called for an 18.2% IRR and I calculate my own at 17.8%. I’m pretty happy with that, even with RealtyShares on their way out of business.
Houston Apartment Building

This is one I bought through Equity Multiple just over a year ago. It offers a 10% preferred return and until recently that was exactly what I had gotten. It’s hard to come to any definitive conclusions until it goes round trip. It’s a 3-year hold so that date is still a couple of years away. They’re aiming for a 15% return. However, I just got a notice this month that demonstrates well what risk showing up looks like in this type of investment.

Over the course of the last few months, we have been working closely with the Sponsor to finalize their 2019 budget which includes a renovation schedule for the remaining units. As mentioned in previous updates [The property is in Houston where there was a hurricane], one of the difficulties that the Sponsor ran into was lack of available subcontractors to effectively work through renovations. As a protective measure, the Sponsor has continued to lease out the Property to tenants on a month-to-month basis in order to generate cash flows and meet debt service.

The plan moving forward will be to renovate 65 units over the next 9-12 months while leasing out finished units at market rates. Eight units are currently under renovation and are scheduled for completion in early March. As part of the new
plan to address labor shortage, the Sponsor has informed us that they have signed employment contracts with electricians, plumbers, and HVAC crews in addition to contracting a larger team to handle carpentry and other renovation work. The Sponsor may add 2-3 more skilled laborers over the next couple weeks to help expedite the entire process and is committed to adhere to the schedule. After many discussions with the Sponsor, we now have a concrete plan in place to complete the unit renovations.

Additionally, we have discussed cash flow distributions with the Sponsor extensively. As noted in previous updates, the initial Interest Reserves have been fully paid out as of November. Per our Partnership Agreement, cash flow distributions to investors thereafter would be funded by available cash flows of the Property. Based on the current plan, distributions are projected to be partial with the remaining shortfall accrued until additional units are renovated and sufficient cash flows are generated. Delays in unit renovation have no doubt negatively impacted the timing of distributions to investors but all accrued amounts on Preferred Equity will be fully repaid ahead of any distributions to the Sponsor.

While the news on current distributions is disappointing, the Houston market continues to be strong and the prospects for an attractive exit remains optimistic.

As you can see, the return is now dropping below the pro-forma and I doubt it will be made up. Will there still be a positive return? Probably. Will it be 15%? Probably not. Is there anything I can do about it? Absolutely not.

**Origin III Fund**

This was my first real estate equity fund. I prefer funds to picking the properties individually. I like the professional
management, diversification and sometimes additional liquidity. This one is sure taking its time getting fully invested though. It’s been doing capital calls for 16 months now and I’m still only 63% invested. That’s fine, I’d rather they not rush it if they don’t have good deals to buy and I’ve got plenty of other places to invest the money in the meantime. Return so far is only 1.54%. The first distribution is supposed to be in about 6 months. Hopefully, we can get fully invested by then! The goal with this one is to double my money over 7 years or so. We’ll see how it goes.

Fort Worth Apartment Building (37th Parallel)

This was purchased in February 2018. It reliably makes a payment once a quarter. Cash on cash return so far is 3.84% (although that will jump up closer to 6% between now and publication of this post when the 4th quarter payment is made.) I think this one is a 10-year hold. We’ll see how it goes. So far it is at pro-forma or very slightly above.

Realty Shares Lover’s Lane

This was a $5K loan to a home flipper through RealtyShares. They took the optional extension for an additional 4 months but always paid as agreed. I made 8.69% and got all my money back last October.

RealtyShares BarTree

This was another $5K loan to a flipper through RealtyShares that also took the extension. It had always paid as agreed until January when it missed a payment for the first time. I’m looking forward to getting my principal back soon given RealtyShares’s recent issues (basically they’re finishing up their current investments and then going out of business).
This is my last RealtyShares investment. 7.24% annualized return so far. Recent notices demonstrate what risk showing up looks like in this asset class. Remember this is a one year investment beginning June 2017.

June 2018:

The sponsor reports that the property is for sale with three other apartment complexes. Several offers were received, the highest of which is $4.4MM or about $28,000 per unit. The sponsor has decided to exercise its 6-month extension to have more time to complete marketing, negotiate offers, and close the sale. The rationale is that with more time to market the property, the sponsor may close on a better offer. The properties can be purchased individually or in a portfolio. The listing price for this property is $1,306,565.

September 2018:

The property is now under contract. The sale price is $1.25MM and the sale is expected to close within 60 days. Your investment will be returned in full with accrued interest upon closing. RealtyShares will update you when the close is confirmed.

January 2019:

The sale fell through. The borrower offered this property with two others he owned in Texarkana to sell as a package. The borrower felt that a sale at a higher dollar amount would attract a wider buying audience. What they found is that a $5MM purchase price was too large for smaller buyers and too large for larger regional buyers. They are back on the market selling the three properties individually. The property is now on the market for $1.2MM. The loan has been extended until June to allow for the consummation of a sale.
RealtyShares Church’s Chicken

This one gave me my principal back in July, always paid as agreed. I made 9.76%

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Fund That Flip Jay Road

This is a $5K hard money loan through Fund That Flip and has had some issues. It made a late payment back in August, then in October filed for an extension. The rehab has been completed but they were still trying to sell the property. They missed their December payment, which was probably a bad sign. Then they finally sold the property in January and I got paid all the interest I was due plus penalties. Final return? 11.29%.

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Fund That Flip Fox Lane

This $5K loan through Fund that Flip also filed an extension, but at least they’re making all their payments. One was a week late, but I’m more concerned that the project on a 1-year loan is only 48% complete after 15 months. Not looking good there. 9.27% so far. At least the late payment and loan extension fees go to the investors.
Fund That Flip 527 East

This one actually completed the project and paid back the loan at the expected time. 10.93%.

AlphaFlow

In late 2017 I got sick of picking these hard money loans myself and decided to outsource it. First stop? AlphaFlow. They basically pick the loans from the various crowdfunding companies and charge me an additional 1% for removing hassle, providing liquidity, and providing diversification. So far, so good. 7.64%. My $22K is spread over 109 notes.

Broadmark II Fund

One of my favorite investments, this is a hard money loan fund that loans to developers in Utah and Colorado. 9.57% so far. They claim returns around 11%, but that’s not what I’m calculating it out as. Part of that may be due to the Colorado taxes being withheld for me, but most of it is just the fact that the reporting comes back a month late and that’s what I use to calculate my return. They changed to REIT status recently, which should qualify this income for the 199A deduction.
**Arixa Secured Fund**

This is another hard money loan fund, lending in California. I calculate my return at 6.02%. That’s always about a month behind just because of the way they report it to me, but they’re only claiming a 2018 return of 7.7%. I find it interesting that most real estate investments calculate returns differently than XIRR. I guess I shouldn’t be surprised. I asked recently why their returns were lower than Broadmark’s. Fund manager Dan Frankel said this:

> It is all about the risk of their loan portfolio versus ours. Lenders can charge higher rates in states like CO and UT because these states will experience more significant value degradation (on % terms) in a down turn, compared to major job centers in coastal CA. We would charge much higher rates in those states as well.

Whether you buy that or not, it appears to be yet another great financial reason not to live (or invest) in California I guess. 3.6% sunshine tax. Either way, I do prefer owning dozens of these loans via these funds rather than a handful of loans picked individually, and for about the same amount of management fees either way.

**My Next Real Estate Investment**

I mentioned this one on the podcast a couple of weeks ago, but I’ll be picking up another hard money loan fund in my portfolio in the next month or so. You are welcome to join me if you like. I’m not yet sure if it will replace AlphaFlow or Arixa eventually but for now it will just be in addition to it. The fund I will be indirectly investing into is the DLP Lending Fund. I won’t be investing directly into it because the minimum investment is a little rich for me ($500K). The fund lends primarily in Pennsylvania, New Jersey, and Florida.
While the PPM allows for a small percentage of the fund to be invested in mezzanine loans, the fund is currently 100% invested in first position real estate investment loans and plans to stay that way. The fund also uses some leverage. There is a 10% preferred return and they aim for 11%+ returns. Since they started in 2014, they have averaged 14.3% returns.

So how am I investing in it if I don’t want to put $500K in? That’s where CityVest comes in. Some of you may recall another fund I mentioned in December in connection with CityVest, one of my site’s sponsors. 40-50 of you invested in that fund, but I wasn’t one of them. CityVest was started by Alan Donenfeld after he recommended his anesthesiologist brother invest in good private real estate funds and then found out his brother, despite being an accredited investor, could not invest in them due to the high minimums. CityVest bands together groups of accredited investors like physicians into an “Access Fund” that then invests in the larger fund. The benefit is a lower minimum investment and usually another price break. The downside is another layer of fees. Here is the deal with the CityVest DLP Access Fund:

**DLP Lending Fund**

- 1% + 80/20 split after the 10% preferred return (First 10% to you, next 2% to manager, then 80/20 above that)
- $500K minimum investment
- 5% exit fee [Update 2/19: This fee no longer exists for any investors and was never for more than the first year anyway.]
- 90 day liquidity
- Monthly distributions
CityVest DLP Access Fund

- $500/year fee
- 0.75% annual fee
- $50,000 one-time organization fee split among all investors in the Access Fund
- $50K minimum investment
- 5% Exit fee waived [Update 2/19: No longer needs to be waived.]
- No liquidity for 3-4 years
- 100 total investors
- Quarterly distributions

WCI Deal

- First year annual fee reduced to 0.375% from 0.75%
- $25K minimum (instead of $50K)

Now I don’t want to put $500K into this fund. I wouldn’t be able to be sufficiently diversified if I did that. But I do want to minimize the fees that come from going through CityVest. There are three ways to do that.

First, I negotiated a lower annual fee for the first year, in addition to a lower minimum ($25K instead of $50K). You have to go through the WCI links to get that. If you go straight to CityVest, you don’t get it.

Second, I want the fund to “fill,” meaning I want all 100 investor slots that its structure allows to be filled. The
more people that invest, the lower my portion of that $50K one-time fee becomes. I also want people to invest more money rather than less. If all 100 investors only invest $25K, that’s a $2.5M fund and that fee is 2%. If all 100 investors invest $100K, that’s a $10M fund and that fee is 0.5%. I think the fund will end up being about $5M honestly, so a 1% fee.

Third, I want my $500 annual fee to be as small of a percentage of my investment as possible. I can do that by investing more than the minimum $25K. Katie and I decided to invest $100K, so that fee is only 0.5% per year.

So my total fees for year one will be

- 1% DLP fee
- 0.37% CityVest annual fee
- ~1% CityVest organization fee
- 0.5% CityVest administrative fee
- Total 2.87%

My fees for years 2-4 will be the

- 1% DLP fee
- 0.75% CityVest fee
- 0.5% CityVest administrative fee
- Total 2.25%

In addition, the DLP manager will earn 20% of returns, although they will not receive any until the investor receives the 10% preferred return.

If they can manage to do what they have done the last four years, I would expect returns of around 12%. This investment will be very tax-inefficient by its nature (hard money loan interest is taxed as ordinary income- no depreciation), but the fund will be taking care of the state tax returns in Pennsylvania and New Jersey using composite returns.

If you wish to join me in this investment with $25-100K+ of
your money, you may do so through this link. Yes, you must be an accredited investor. Now don’t be stupid and invest some huge percentage of your portfolio in this; diversification still matters. I only have 5% of my portfolio in real estate debt and even that is split among 4 different managers.

In case it isn’t incredibly obvious, I GET PAID IF YOU INVEST WITH CITYVEST THROUGH THE AFFILIATE LINKS ON THIS PAGE. Affiliate marketing is one of the ways this for-profit website makes money. So obviously I have a huge conflict of interest in this regard and I have no legal fiduciary duty to you. You can read more about my conflicts of interest here. You can get started investing with the link below or you can call up Alan Donenfeld at 212-593-1600 and let him know WCI sent you to get the WCI deal. If you want to learn more, there is a webinar on Tuesday and Wednesday this week at 2 pm EST.

Invest in the CityVest DLP Access Fund Today!

Physician on FIRE

Moving away from the real estate debt, let’s talk about my best investments — the WCI Network. Physician on FIRE continues to send me quarterly checks and I calculate out my ROI at an annualized 289%.

Passive Income MD

My best investment, however, is the king of cash flow himself. Nothing better than getting passive income from Passive Income MD. 851% annualized return there. I highly encourage you to continue to support these fine websites.
I invest in real estate in hopes of high returns, low correlation with stocks and bonds, and being paid for liquidity.

Overall, the returns on the 5% of my portfolio invested in real estate debt were 9.13% in 2018. The returns on the 10% of my portfolio invested in equity (heavily boosted by WCI Network returns) were 85%.

Most of my investing money the last few months has been going into stocks to try to rebalance the portfolio. Strong performance from real estate/alternatives combined with poor stock market performance has forced me to do that. But I’m sure I’ll be looking at more real estate investments soon. If you’re interested in real estate investing, take a look at some of my affiliate partners (More details found on this page.)

- CityVest
- CrowdStreet
What do you think? Do you invest in anything besides index funds? How have those alternatives treated you? How have you chosen to invest in real estate? Comment below!

4 Ways to Accelerate the Power of Compound Interest

[This is a guest post from Michael Episcope, co-founder of Origin Investments which provides real estate equity funds to individuals. Origin Investments has been a paid advertiser on this site, however, this is not a sponsored post.]
The secret to growing wealth is not only making wise investments but also putting earnings to work to generate even more earnings. Money grows faster over time. When interest, dividends and capital gains on investments are left to accumulate, they grow exponentially—earning interest on not only the original investments, but also the accumulated earnings.

**Calculate Compound Interest with the Rule of 72**

A useful shortcut to help calculate the rate of compounding at a given interest rate or expected investment return is the rule of 72. By taking the interest rate or the expected return and dividing it by 72, the result is the number of years it will take to double your money. Using this formula, a 9% return will double every 8 years. (72 divided by 9=8)

Even a single percentage point more in annual returns add up to big dollars when you do the math. For example, over 35 years a $1 million investment portfolio generating gains of 6% annually will be worth $7.69 million, while a 7% annual return will generate a portfolio value of $10.68 million. That’s a difference of 39%.

Albert Einstein is said to have called compounding the eighth wonder of the world. Whether or not that’s true, it’s clear
that keeping your money working at all times and making money on your money is the key to getting and staying wealthy. By making a few portfolio tweaks or managing cash more effectively, nearly every investor can find a way to generate another 1% to 2% annually on their portfolios. It requires discipline, but the steps are simple:

4 Ways to Accelerate the Power of Compounding

#1 Focus on asset classes with high expected returns

Portfolio optimization is a tool used by virtually every wealth manager to create risk-adjusted portfolios, but it comes at a cost by trading volatility for return potential. That’s because portfolio maximization doesn’t focus on maximizing long-term wealth, but rather minimizing long-term loss—For that reason, many portfolios are “over-diversified” with asset classes that are included to lower volatility.

David Swensen, CIO of Yale University’s endowment—the world’s second largest according to the New York Times, focuses the school’s investment dollars on alternative asset classes with high return potential. Very little of the Yale portfolio is in bonds or cash. Why? While bonds are a great tool to smooth the
ups and downs of a portfolio, they don’t earn significant returns. And what’s the point of having bonds in a portfolio if you have a 25-35-year investment time horizon? Over that period, odds are you will achieve the long-term historical average of any asset class. So why not invest in an asset class with a high expected return?

Instead, Yale’s endowment has assets in both the public and private markets to optimize returns. To be clear, the Yale portfolio is highly diversified across various asset classes, each with the potential to generate sizable returns. It’s this strategy that has helped Swensen achieve annualized rates of return in excess of 12% over the last 30 years. Alternative investments such as real estate and venture capital played a key role in generating these returns.

#2 Scrutinize every fee

Investors pay fees directly to wealth managers or investment accounts, and indirectly to managers of the underlying assets. The fee for wealth managers today is somewhere between 0.3% and 1.0% on assets under management. To find lower management fees, consider re-negotiating or using a robo-advisor. Robo advisors such as Betterment and Wealthfront provide similar asset management services as traditional advisors but for a fraction of the cost.

Moving beyond advisory fees, pay close attention to investment vehicles and how their fees are structured. Passive investing has proven to beat active investing time and time again, but finding the lowest cost provider is essential. Are you in a Vanguard index fund paying 0.1% or a mutual fund paying 0.6%? Switching is simple and easy.

It’s often the hidden fees we don’t see that are the ones that destroy returns the most. The race to low fee or no fee solutions has forced companies like Robinhood to find other ways to fee customers. No one works for free and companies must make money so beware of these marketing tricks. Don’t
penalize a company for putting their fees up front and center. A 1% fee can sometimes be a lot less expensive than free.

#3 Manage cash appropriately

Cash is king, but too much of it can stink up a portfolio’s return potential. Cash in an investment portfolio can drag portfolio returns down substantially because it earns next to nothing. If 20% of a portfolio is in cash, then the other 80% must work even harder to achieve your portfolio return goals. Determine how much cash you need and make sure the rest is invested appropriately, even if it’s just in an overnight money market account earning 1 or 2%. If your cash is sitting in your checking or savings account, chances are that you are earning less than 0.25%.

The biggest mistake investors make when committing to closed-end funds is setting aside their commitment in cash. In many cases, it can take years for the manager to call this capital and that’s a lost opportunity. This commitment needs to stay invested until it’s called. Over the short term, you may realize some downdrafts, but the potential funding shortfall can be easily managed by maintaining a healthy cushion in your liquid portfolio. On the back end, make sure distributions are immediately invested instead of just sitting in your bank account. In the long run, managing money in this way will reap
the greatest portfolio benefits.

#4 Invest for the long-term – Set it and forget it

It’s not about timing the market but how much time you are in the market that matters. Generating a steady 7% return and managing your capital in a tax efficient manner is far better than chasing short term returns or throwing darts at the wall trying to guess the daily ups and downs of the market.

Consider this: from 1998 to 2017 the stock market generated a 7.2% annualized return. If you missed the 20 best days of those 20 years, your return would have been only 1.15%. That’s the difference between having $1,256,950 and $4,016,943. No one knows when those best 20 days will happen, which is why staying invested matters.

No portfolio grows at a steady 7%, but over the long run, the right assets managed appropriately can be optimized for a predictable expected return. The danger in optimizing a portfolio, though, is to focus on minimizing long-term loss rather than maximizing long-term wealth. Wealth managers often diversify away risk so much that they also diversify away the ability to make any real wealth. If you have a 30-year time horizon, why are you investing in bonds? Moving that money into alternatives with high return potential is a far better solution so long as you can identify the right funds.
By combining traditional assets with high potential alternatives, investors can make long-term plans that give them the best options for appreciation. An adviser may have 50 to 100 relationships but you have only one. Stay on top of your portfolio and don’t be afraid to challenge the status quo because it’s your nest egg that’s on the line. The **job of the advisor** is to not lose you money, but the absence of loss is not gain. Work with them to craft a plan that not only preserves your wealth but also affords you the ability to build wealth. Finding that extra 1-2% in returns is fairly easy if you follow some of the steps outlined above and can pay huge dividends down the line.

*Do you agree with these recommendations for increasing investment returns? Why or why not? Comment below!*

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**Private Real Estate Funds – Podcast #93**
You may have been expecting podcast #92 this week if you are keeping track, but you will have to wait a week or two for it. Our guest, a military physician, was told at the last minute of a requirement that the military had to sign off on the podcast transcript before it went live. So hopefully that will run next week. Instead this week we are going to talk about private real estate funds. At the beginning of the episode, I give the disclaimer that alternative investments, including real estate, are 100% optional to your portfolio. You don’t have to invest in any of them in order to be financially successful. And there is an easy way to invest in real estate called the Vanguard Real Estate Investment Trust Index Fund. So with those two disclaimers, we talk about my experience investing in real estate. I invested with several crowdfunding real estate companies. When my income increased I moved on to real estate funds, that had higher minimums, and have had good success there. But I’m always looking for other funds, not only to provide diversification, but just to see people who are doing this well. The real difficulty with the funds is the relatively high minimums. I’ve negotiated another opportunity with CityVest for you to invest in a fund with a lower minimum. I share all the details in this episode for those
interested in investing in this asset class.

Podcast #93 Sponsor

This episode is sponsored by Chad Chubb of WealthKeel. Based in Philadelphia, WealthKeel is a financial planning firm that works with physicians across the country. WealthKeel specializes in crafting straightforward, actionable financial plans for Gen X & Gen Y physicians. They navigate through the increasingly complex decisions you have to make with your money, allowing you to free up time and energy to focus on your family, your work, and what you love most.

WealthKeel utilizes a simple flat-fee structure to offer both financial planning and investment management, as well as project specific hourly advice. Chad is a Certified Financial Planner® and fiduciary for physicians and their families. He has been quoted by Medical Economics, the American Medical Association, and CNBC for his work with physicians. Over the years countless WCI readers, both delegators and do-it-yourselfers, have trusted Chad and his team at WealthKeel for ongoing financial planning and one-time plans. To learn more schedule your free Icebreaker Call or email Chad directly at chadchubb@wealthkeel.com.
Quote of the Day

Our quote of the day today comes from Morgan Housel who said, “Enough people have been bamboozled by the finance industry that a sense of, ‘if it sounds too good to be true, it probably is’ has enveloped even rational promotions of optimism.”

Real Estate

I gave the disclaimer that alternative investments, including real estate, are 100% optional. You do not have to invest in any of them in order to be financially successful. Funded adequately, investing 20% of your gross income in a boring strategy like a Vanguard target retirement or life strategy fund throughout your career will lead you to retire as a multimillionaire, especially when the use of retirement accounts is maximized. Keep that in mind. Everything going forward from this point in the podcast is totally optional as an investor.

Second, there is a very easy way to invest in real estate called the Vanguard REIT Index Fund. This fund buys up all of the publicly traded Real Estate Investment Trusts in the United States. There is a similar fund for international REITs. Like any Vanguard mutual fund, this fund offers a passive investing strategy, very low costs (0.12%), professional management, and daily liquidity. Many investors have chosen to add this fund to their portfolio because its correlation with the overall market is only moderate. It is 0.46. 0 is completely uncorrelated, that’s about what the correlation between stocks and bonds is. Correlation between the overall market and small value right now is .93. So in that respect, 0.46 really does offer some significant diversification benefit.

There is no doubt that publicly traded REITs are influenced by
the whims of the overall market place. It lost over 6% in December for instance. Sometimes, REITs get absolutely hammered. In 2008, that fund lost 78% of its value from peak to trough. This makes a lot of real estate investors nervous. The truth is their real estate values do fluctuate daily, but the volatility is somewhat hidden to them because the value of the asset isn’t marked to market daily like a publicly traded stock or mutual fund. Some real estate investors also want to be paid for illiquidity. By giving some of that up, they hope to get a little extra return with part of their portfolio. Also, since real estate is not nearly as efficient a market as stocks, they also often hope to add value through active management.

My Experience with Real Estate Investing

My experience with alternatives really began back in 2012 with Lending Club. I had good returns, about 12%, but there is nothing backing that asset. As institutional money came in, returns became lower and it seemed silly to be loaning unsecured money for 8% when I could loan it on secured assets and make at least that. Plus the shenanigans and platform risk bothered me.

So I went to crowdfunding real estate companies. I had a great experience. I got all my money back and made good returns. The
minimum investments were pretty low, from $2-20K. But it never felt very diversified and it certainly wasn’t as passive as I would like. I did this both on the equity and the debt side, 10% and 5% respectively.

In an effort to make it more passive and diversified, I tried a firm called AlphaFlow. This is technically an RIA that charges 1% a year. But I was willing to give up 1% in order to be investing in dozens of loans instead of a handful, to not have to pick them out myself, and to provide liquidity. The returns were about what I had been getting, minus the 1% fee.

Then I started making a lot more money. I was already an accredited investor, but all of a sudden the minimums on some of these real estate funds were less of a problem for me. I could come up with $50-$100K per fund. So I branched out a bit, particularly in my hard money lending. I went to a fund called Broadmark. I think I got into it for 75,000. They basically give you a 6% return on those hard money loans and then after that, you split the profits with the fund at 80, 20. You get 80, they get 20. That has been a great investment for me. Over time I have made about 10% or so a year on that and it’s been pretty steady month after month.

I also reached out to another fund put on by Arixa Capital which is a firm that does hard money loans in California. They charge 1.75% per year, which seems really high when you compare it to mutual funds. But you have to bear in mind that you’re not exactly comparing apples to apples. I ended up with returns in the 7% or so range from that.

But I’m always looking for other funds, not only to provide diversification but just to see people who are doing this well. Hard money lending is not particularly complicated. It is basically house flippers that need cash to fix up a house and then sell the house in six or 12 months. These funds are doing the same thing that was being done through the crowdfunded sites online. The developer comes to them and
says, “Hey, I need a loan for six months. The higher interest rate doesn’t bother me, that’s just a cost of doing business, but I need to close the loan quickly.” The hard money lenders can close their loan in three days or a week as long as they meet their underwriting criteria. The benefit for these funds is, yes each loan might be short term, but the fund isn’t short term. So over the long run, if you can charge these guys 10-14% interest on the loans, there is a lot of money there to be made for the investors. The difficulty is, these funds tend to have relatively high minimums.

Investing with CityVest

Alan Donenfeld with CityVest ran into this problem of high minimums to invest in these funds when he approached his brother who is an anesthesiologist. Alan told him he should probably be investing in real estate because it was a great asset class with great returns. His brother looked at the private real estate funds and told him even with a multi-million dollar portfolio he couldn’t get into these funds with million dollar minimums and still be reasonably diversified.

Alan looked into solving this problem for people who were accredited investors, meaning they had an income of $200,000 single, or $300,000 married, or investable assets of a million or more. They qualified for these investments but couldn’t come up with the minimums. CityVest forms access funds, basically putting itself as an intermediary between these big funds with high minimums and the individual accredited investors. By putting themselves in there and forming this access fund, they can lower the minimum investment for the investors. And sometimes negotiate a little bit better terms. Not a lot of doctors can come up with $100,000 at a time to invest in a fund like this, certainly not in the first half of their career, but a lot of docs can invest $25,000 at a time. That was the situation with the CityVest proposition I discussed on the blog last December. Lots of white coat
investors got into that fund with the lower minimum.

Now CityVest has another fund that they are forming and expect to close certainly by the end of March. This is another access fund and the fund that it will invest in is a DLP lending fund. This access fund is going to gather up money, form this fund of several million dollars and then take that money and invest into the DLP fund. It is a good opportunity to get into this sort of asset class. DLP has an excellent track record. It is not that long, they only started in the last quarter of 2014. But their records are very good. It is up over 14% what they have given to their investors so far, doing these hard money loans. There is lots of pressure in this space and so it wouldn’t surprise me if the returns were a little bit lower going forward from here. But this fund does well. It has done well in the past, and every expectation is that it will continue to do well going forward.

Now, this particular fund, the DLP fund is basically an evergreen fund. It is not a fund with a stop date. But the access fund to be formed by CityVest is. The plan is for this fund to run three or maybe four years. It could possibly be extended another year if all the investors agreed to do it. But mostly this is going to be a three to four year investment. There is not going to be any liquidity in those three to four years. You can’t get your money out if you need it. But over that time period, the expectation is that it will provide nice solid returns and exposure to this asset class of hard money lending.
If you go to DLP directly, you have to have a quarter million dollars to invest in the fund. That is a big hurdle to get over for a doctor, especially if you want to have any sort of diversified portfolio. I mean, I only put 5% of my entire portfolio into hard money loans and so if I want to have three or four different funds out of that 5%, well, that takes a very large portfolio to put $250,000 in a single fund.

DLP charges 1% a year to the investors and they charge when you exit the fund, a 5% fee. It is kind of like a back load that way but I think the idea is to incentivize you to leave your money there long term rather than jumping in and out.

So the proposition here from CityVest is that they will put together an access fund that allows up to 100 investors to invest with a minimum of $50,000 instead of $250,000. They also negotiated so that the 5% fee to exit DLP won’t exist for those who come through their access fund.

Of course, anytime you put somebody else in there, there’s going to be some additional fees. CityVest charges three fees. The first one is a one time fee that is spread over all of the investors in the fund. This is a $50,000 fee to basically set up the fund. So depending on how much money is invested in the fund, it depends on how much of a fee that really is. If $5 million gets invested, that’s about 1%. If $10 million gets invested, that’s about .5%.
The second fee is charged each individual investor, it’s $500 a year. That is to cover the costs of running the fund. That works out to be about 2% a year, if you invest $25,000, or if you invest $50,000, that’s about 1% a year, if you invest $100,000 it’s .5% a year. So how high that fee is depends on how much you invest.

Then the last fee is .75% a year paid to CityVest. In exchange for those fees, they give you a lower minimum and they manage to get that 5% exit fee waived for you. That is the proposition CityVest is making.

They came to me looking for more investors. If I refer doctors to them, they will pay me out of the fees they earn from the doctors. Typically with all of my affiliate deals I try to negotiate a good deal for WCI readers and listeners. So with this affiliate deal I wanted value to be added for the investor at each step. If you decide to invest with CityVest and go through the links on the site, here is what I’ve negotiated for you.

1. The minimum investment has been lowered from $50,000 to $25,000 for you.
2. The 0.75% annual fee for the first year will be cut in half.

That is the incentive for you to come through my links rather than go directly to CityVest to invest in the fund. Even after those fees, if this fund makes the 14 and a half percent it has been making, you’re still going to be making 10-12%. It is an excellent return for a hard money lending fund.

The DLP fund lends primarily in Pennsylvania, Florida, and a little bit in New Jersey. The type of houses they are lending money for are a little bit C and B class houses rather than A class houses, cheaper houses basically that allows them to charge a little bit more.

I expect I’m going to invest in this deal as well. I haven’t
decided how much I’m going to put in, obviously, the minimum will be 25,000, but I suspect I’m probably going to be closer to the 50 to $100,000 level just because I want to minimize those fees. That $500 per investor fee, is much lower as a percentage of the return if you invest 100,000 verses 25,000. Also, the incentive of course, is to get as many investors in the fund as possible. I don’t think we’re going to have trouble getting the maximum 100 in there but to have each of those 100 invest as much as possible because the more invested in the fund, the more that initial $50,000 fee is spread out over and lowers that fee relative to the entire investment.

If you would like to join me on this investment or learn more about it, go to CityVest and talk to Alan Donenfeld. Go over the paperwork and ask him any questions you want to about the deal. I’ll be talking about it a little bit more on social media, maybe even on the blog a little bit in the coming weeks, but that’s basically the explanation of the deal. Make sure if you want that special deal to be able to only invest 25,000 and to get half of your first year’s fee waived, you let them know you came from White Coat Investor.

**Listener Questions**

**A Windfall of Money**

One listener’s large practice was purchased by a private equity group. He wondered what to do with money from a one time deal like that.

The IRS is going to treat that money as income to you, you have to pay taxes on it in that year. But anytime you make money, it all really goes into the same pot, no matter where the money came from. Whether it came from your investments, your spouse’s income, your income, inheritance, it is all the same. It is just a common behavioral mistake that people make to treat it as some separate amount, just because you had
this windfall coming in, you have to do something different with it and that is not necessarily the case.

Hopefully, everybody listening to this podcast will get some sort of a windfall during the course of their life. You don’t know how much it’s going to be, you don’t know when it’s going to come but chances are, you’re going to receive something that maybe you weren’t expecting. And that’s really my definition of a windfall. But there is really three categories of windfalls:

1. The first one is the one I call spare cash. This is money you weren’t expecting. I would just take that money and kind of fold it into my existing financial plan, whether that is paying off student loans, paying down a mortgage, or maxing out retirement accounts. I just take that money and divide it among my goals in whatever manner I see fit, just like any other money you made, like your monthly paycheck.

2. The second category is enough money to make you financially independent, enough to change your life in a significant way. This is the amount that this doc was talking about in the question. The best thing to do upon getting that level of money, is probably nothing. Do nothing for a few months, or maybe even a year, give it some time and really think about what you’re going to do with your life. If you’re ready to retire already, go ahead and do so. If you want to get out of medicine, and do something else, you can do that too. If you love what you’re doing, maybe you put a chunk toward retirement, give some away and you spend some.

3. The third category is ridiculous money, like lottery winnings, which if you invest it wisely that is more money than you could ever spend given your current lifestyle. At this point, you’re going to need to engage in some pretty serious estate planning. You have a real opportunity to make a change in your community
and in the world. So this is a responsibility that you can’t take lightly. Consider annuitizing some of the money. You hear about all these lottery winners that go broke. You can’t go broke if you ended up annuitizing it such that it’s going to pay you out a certain amount every month from now until the day you die. It is also a great time to get some solid unbiased advice at a fair hourly rate from a CPA and an attorney about estate planning and asset protection. Put a big chunk of it into a safe investment. You no longer need to take as much risk.

It makes me think about what Andrew Tobias recommended in The Only Investment Guide You’ll Ever Need. Here is what he said you should do if you win a million dollars,

“Go out for a very nice dinner, put about one year of normal living expense someplace liquid like a bank or money market fund, and then put roughly equal sums into US Treasury securities, maturing in one, two, three and four years. Then put the bulk of the remaining money into stock index fund split between US and foreign investments. Buy a bigger house if you want one, but not so big that the cost of carrying it will strain you in any way. Maybe even consider buying a small rental property but don’t buy a boat. Make sure your will is in order and then relax and forget the whole thing.”

I agree. I think it is important to spend some of it. Don’t go crazy, buying some massive yacht or something, but spend a little bit of the money. And then give some of it away, maybe some to your family but mostly to real charities that are going to do some good in the world. I think that helps you keep money in the proper place in your life. And of course, remember that one of the benefits of having enough money is that you don’t have to maximize everything out. You can use this to worry less about money because you have more now, whether that comes from winning the lottery or selling your
practice. Bear in mind one difference with selling your practice, particularly to some of these corporate management groups, is that it often comes with a lower future income. You’re trading a lump sum now for a lower income later. Keep that in mind, if you’re going to be making less money going forward, you have to plan your lifestyle going forward on less money and put a lot of the windfall toward retirement.

**Becoming a Stay at Home Parent**

The wife of a pediatric anesthesiologist coming out of fellowship asked what are some of the things that they should be thinking about and considering to see if they can afford for her to quit her job and become a stay at home mom? He is going for PSLF in five years and they have two kids with a full-time nanny.

I think this is actually a really common concern, particularly in the traditional scenario where the guy is the doctor. He has been plugging through medical school, residency, and fellowship being supported by his wife, maybe with or without children.

This doctor is going from a fellow salary to an attending pediatric anesthesiologist salary. There is no doubt in my mind that if they keep their lifestyle under control, she can certainly quit, walk away and never work again. He’s going to have enough income to take care of business, to save up enough for retirement, to pay off any debt, and to pay for the house.

Here are a few things to consider though.

1. Your income is not going to be as high as it would be if you continue to work. It is going to be a little bit slower to reach your financial goals. But the income drop might not be all that much, depending on how much she is making. They will no longer need to pay for the nanny and pay less in taxes.
2. If you are no longer working, you are going to probably want to have a little more life and disability insurance on the breadwinner. And some life insurance on the person who is being a stay at home parent because what they’re doing has real value and you can calculate the economic value of it by looking at what a nanny and housekeeper costs and additional meals out.

3. The most important long term issue here is the effect on her career. When you take significant time out of the workplace, chances are your long term earnings are going to be lower and it will be harder to get back into the workplace. You will probably not be as far along in your career as somebody who spent more time in that career rather than taking time off to raise a family and it might be impossible to get employed at all. If you’re sure you’ll never go back to work, no big deal. If you think you might, you may want to look into part-time work, to keep your skills up.

Teaching Children to be Financially Literate and Charitable

One listener asked for advice on how to teach children to be financially literate, unspoiled, and charitable. A tall order! It is difficult.

I think the financially literate part is the easy part. It is relatively easy to teach your kids about money once you understand it yourself. We start very young. I make my kids listen to Dave Ramsey on the radio sometimes when we’re driving around in the evening to their activities. They all scream and cry about it. But in the end, some of those lessons are being absorbed and they’re learning to pay attention to finances. They’re learning about the dangers of debt. You just have to talk to your kids about money. You would be surprised, it is not that complicated. A lot of it can be learned at relatively young ages. You can even give them books written
specifically for kids.

All of my kids have had some sort of entrepreneurial pursuit, it might be a lemonade stand or shoveling driveways for somebody else. You also have opportunities at times when they’re trying to raise money for something to have them earn a certain percentage of it themselves. For example, in June, Whitney and I are going to Honduras on a medical mission. She wanted to go along and I told her she had to raise a certain amount of the money to be able to go. She is coming up with all kinds of ways to raise money. I think it is good to teach them a little bit about entrepreneurship that way.

The other two questions, unspoiled and charitable, are a lot more difficult. Let’s take the charitable one first. We give away a lot of money and we want to pass that value on to our children. Once a year we have a family meeting and decide what charities we’re going to support with our money that year. Each person in the family gets an equal say. We go around and battle it out. You have to argue for your favorite charity. I wasn’t able to talk anybody else in the family into donating to the access fund this year, which is a charity that basically helps keep climbing areas open. But we ended up donating to other charities instead.

I think actually involving the children in the family finances in a way that’s appropriate is also a great way to teach them to be charitable. Not only money though, also with time. You can take them out and do service projects and those sorts of things with them.

It also helps, particularly when traveling, to point out that not everyone has the advantages and opportunities that they have, which kind of segues us into the unspoiled section. This is the big challenge I think when you start making decent money, particularly way more money than either of you grew up with. I don’t think I have all the answers on this one for sure. But I think some things that you can do are to limit
what they have. Just because you can afford to send them to school in a Range Rover doesn’t mean you should. Just because you can afford to buy them a $6,000 purse doesn’t mean you should, just because you can afford an iPhone, maybe they should have a flip phone until they reach a certain age.

Artificially limiting how much money they see in their lifestyle is beneficial to them. It also helps to talk to them about the times in your life when you really didn’t have that much money. I’m constantly reminding my kids that when they turn 18 and get their own car and their own house and their own job that they can do whatever they want and until then they have to follow my rules. That is kind of a constant reminder to them that at a certain point in their life, they’re going to be responsible for themselves and have to live on their own income.

I think it’s also important to make sure you don’t give them too much money, particularly earlier on in life to ruin them. I mean, most of us make enough money that we can truly ruin our kids and so I think you have to be really careful how much and how you pass that money on to them. And hopefully, as they prove that they can use it responsibly you can give them a little bit more.

**Term Life Insurance Companies**

“You always speak of buying the cheapest term life insurance policy one can get at places like term4sale.com. But when I purchased my own policy I worried a lot about the financial health of the insurance company, especially when one buys a term of 20 plus years. Should a young doctor worry about getting a policy from financially sound companies only, even if they cost a bit more? After all, if something were to happen, you’d want them to actually pay out.”

How much does the strength of the insurance company matter
when it comes to term life insurance? And I think it matters. I don’t think it matters as much as a lot of insurance agents think it matters, but it’s worth looking at. At Term4Sale companies are rated A++, A+, A, A-, those are basically superiors, superior, excellent, excellent. The default on the site is that they only show you companies that are excellent and up.

I ran my numbers on the site recently and the cheapest company was still rated an A. I don’t think this is really a big issue in practicality as long as you’re not going to go to a D company or an F company or probably even a B company. But is it worth dropping down below A plus plus to save 100 bucks a year? I think it probably is. I’d be comfortable with anything that’s rated A or higher and wouldn’t think twice about it. But if you’re really worried about it, pay another hundred bucks a year and get one of the very top rated companies.

Financial Conflicts of Interest in Medicine

I received some feedback from Podcast 85 where I interviewed a young periodontist.

“I was surprised to hear you say that medicine is more insulated from financial conflicts of interest because of the opaqueness of insurance reimbursement. Personally, I feel like I am wrestling with a devil on my shoulder everyday with regards to conflicts of interest. I’m an academic vascular surgeon and I am on a contract that is heavily dependent on RVU generation, and this seems to be the norm in many academic/employed contracts. When I do a lower extremity angiogram, a diagnostic procedure reimburses 4.5 rvus, this increases by 100% if I do an angioplasty and 150% if I do an atherectomy. To make matters worse, there is little time difference in any of the above, and murky data to guide therapeutic modality choice. I’m constantly weighing evidence
based medicine and best practices against that little voice
telling you to earn more. I can’t imagine I’m the only one
else out there with this feeling, in fact I’ve heard docs
joke “Dr. So and So doesn’t participate in non-RVU generating
activities”. I would love to hear more discussion about this
because I think these sorts of production contracts are
becoming so ubiquitous.”

Certainly, there are ways in which you can have conflicts of
interest in medicine without a doubt. I think this surgeon
describes about as bad as they get. For example, if you are on
a salary, just a flat salary, say you’re a military doc, there
is basically no conflict of interest there whatsoever. In my
group, it is not completely eat what you kill, but we are the
business owners. At the end of the day, we split up what’s
left and divide it by how many shifts you worked in that
month.

That insulates you a little bit from the day to day decisions.
Yes, you know that if you do things that bill more, you’re
going to make more money. But since the group has 18 docs in
it, every little decision you make, you’re really only getting
1/18th of the difference in that additional money that comes
in from making a decision one way or another. I think the
conflict of interest there is much, much smaller and much
easier to resist, than if you are 100% based on RVU
compensation. I think a minority of doctors are 100% RVU
based. So compared to a lot of other professions, your
conflicts of interest are much smaller. Are they invisible?
Obviously not. And this doc has given a great example of when
they are not.

**Single Stock Holders in Taxable Account**

Also, I received some feedback from Podcast 86, regarding
legacy holdings in taxable accounts.
“There is another way to diversify a single stock holding without selling, donating, or gifting the shares. It involves using an exchange fund. It’s relatively unknown among most investors and typically requires a significant, single stock holding ($500,000+), but exchange funds allow you to contribute your single stock into a pool of other stocks formed by the exchange fund and then when you withdraw your capital, your single stock holding converts into a basket of diversified stocks (and often some real estate, by law) from the pool without triggering capital gains taxes. Obviously, there are fees paid to the exchange fund that make the magic happen.”

He says Eaton Vance provides one of these exchange funds. So this is another way to achieving diversification with the same amount of capital gains. So this is one other option if you’re trying to get rid of a very concentrated holding and diversify your portfolio a bit.

Ending

Thank you for the feedback. This is a great community to find answers to your financial questions. Ask in the WCI Forum or in the WCI Facebook group. Or if you want to have your questions answered on the podcast go record them here!

If you are interested in investing in the CityVest access fund you can get more information at CityVest.

Full Transcription

This is the White Coat Investor podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high income professionals stop doing dumb things with their money since 2011. Here’s your host, Dr. Jim Dahle.
Welcome to White Coat Investor podcast number 93 Private Real Estate Funds. This episode is sponsored by Chad Chubb of WealthKeel based in Philadelphia. WealthKeel is a financial planning firm that works with physicians across the country. WealthKeel specializes in crafting straightforward, actionable financial plans for Generation X and Generation Y physicians.

They navigate through the increasingly complex decisions you have to make with your money, allowing you to free up time and energy to focus on your family, your work and what you love most. To learn more and to schedule your FREE icebreaker session, call 267-590-9533 or visit wealthkeel.com/wci or email Chad directly at Chadchubb@wealthkeel.com. Thank you for what you do. I know your daily work is not easy, that’s why you had to train for it for so long. I was called to the floor from the ER for a code the other day, it wasn’t actually a code, they just needed some assistance.

It turned out one of the patients had pulled out his dialysis catheter and bled all over the place. It was pretty impressive, the amount of blood that was underneath him once we rolled him up, which certainly explained why his blood pressure was 60 over 30. Luckily, the nurse had stopped the bleeding with some direct pressure and all the patient needed was some blood which we promptly gave him. And his blood pressure, as you might imagine, became much more normal. But even those little things you realize are life saving
Interventions that we do all of the time. And it really does make a difference in people’s lives. So thank you for what you do if nobody else is thanking you. Hopefully, you’re at least getting it from me.

I know this is podcast number 93 and you might have been expecting podcast 92 this week. We will be getting the 92 here in the next week or two, it’s actually all recorded and ready to go. But it turned out our guest, who is a military physician actually had a requirement that the military had to sign off on the podcast transcript before it went live. So we’d give them another week or two to get that done in order to comply with their demands. We want to thank all of you in the military for your service and recognize that there are often a lot of additional red tape issues with doing that.

Thank you to those of you who are leaving us questions at speakpipe.com/whitecoatinvestor. We’re getting more and more of those, in fact, it’s not going to be very long before those are probably the only questions we’re going to do on the podcast. And you won’t be able to just email me or tweet me something and get it on the podcast. I think we’ve got 10 or 12 now in the queue, and since we only do a handful of them every episode, it probably at this rate are going to be most of the questions we do. Be sure also that you’ve checked out the White Coat Investor network blogs.

This includes Passive Income MD, the blog written by Peter Kim who lives in California in a relatively high cost of living area. And it really focuses on boosting the income of physicians and increasing their passive income. He talks about lots of things, big focus on real estate there, but other kind of side gigs as well as other ways to really boost your income, great blog. The other one is Physician on FIRE. This one is written by Leif Dahleen also an anesthesiologist like Peter, but one who is probably going to be retired here within a few months.
He’s based out of the great White North just about, he’s up in Minnesota suffering through a terribly cold winter it sounds like. But he writes his blog all about FIRE financial independence and retire early. And it is a great resource for those who are ready to become financially independent particularly if you’re interested in getting out of medicine altogether. Also, if you haven’t followed us on Instagram and Pinterest, that’s our new thing. We had actually a fantastic month last month. I think our number of Pinterest followers went up by like 50% in a single month. So there’s still time to get in on the ground floor there.

Katie and I had an interesting day, this last month of January. We went down to Vegas one morning, we booked flights and went down there. And they actually picked us up at the airport in a limo. And drove us around from casino to casino in a limo while we checked out the various conference space available in Vegas for our White Coat Investor Con 20. We’re looking forward to this, it’s going to be in March 2020 still trying to decide exactly which hotel we’re going to have it in as well as which week it’s going to be. The first week or the second week of that month, but really looking forward to that. It turns out if you tell them you’re bringing a 600 person party to Las Vegas for three or four days, they’ll pick you up in a limo and drive you around as well.

Our quote of the day today comes from Morgan Housel who said, “Enough people have been bamboozled by the finance industry that a sense of, ‘if it sounds too good to be true, it probably is’ has enveloped even rational promotions of optimism.”

Okay, before we get into today’s questions from readers, I want to talk for a few minutes about real estate in general and private real estate funds in particular. First though, a bit of a disclaimer, alternative investments including real estate, are 100% optional to your portfolio. You don’t have to invest in any of them in order to be financially successful.
Funded adequately, investing 20% of your gross income into a boring strategy, like a Vanguard Target Retirement Fund or a Life Strategy Fund will lead you to retire as a multimillionaire, on a typical physician income, especially when you’re maximizing the use of retirement accounts. So keep that in mind. Everything going forward from this point in the podcast is totally optional as an investor. Second, there’s a really easy way to invest in real estate called the Vanguard REIT or Real Estate Investment Trust Index Fund.

This fund buys up all of the publicly traded, real estate investment trusts in the United States, this buys them all. Basically follows and tracks the index of them. There’s a similar fund at Vanguard for international REITs as well. And like any Vanguard mutual fund, this fund offers a passive investing strategy, very low costs about 12 basis points a year, professional management and daily liquidity. And many investors have chosen to add that fund to their portfolio because its correlation with the overall market is only moderate. If you actually look at the correlation the day I recorded the podcast, it was .46.

So one is perfect correlation, zero is no correlation whatsoever, minus one is negative correlation. The correlation between the total stock market and the Vanguard REIT index fund is .46. It’s not uncorrelated completely but it’s significantly less than most stock investments. Obviously, it’s not as uncorrelated as stocks and bonds. The correlation between those two is like .01. I mean, they’re almost completely uncorrelated. But there’s definitely some diversification benefit there with the REIT index fund. In fact, a lot more than a lot of other stock asset classes that you might invest in.

For example, I checked today what the correlation is between the total stock market and the small value index fund. And it was point nine three so much, much higher than the .46, you get out of the REIT index fund. However, there is no doubt
that publicly traded REITs are influenced by the whims of the overall marketplace. In December, for instance, the REIT index fund lost 6%. When the market goes down, those do go down even with no seeming change in the real estate market. And sometimes REITs get absolutely hammered, in 2008 that Vanguard REIT index fund and I know because I owned it, lost 78% of its value from the peak to the trough.

And that makes a lot of investors including real estate investors nervous. The truth is, real estate does fluctuate in value daily. But the volatility is somewhat hidden to the investors because the value of the asset isn’t to market daily, like a publicly traded stock or mutual fund. Also, one reason why people may opt to invest in something besides publicly traded REITs, is because they want to be paid for being illiquid. There is a premium for being willing to give up your liquidity and they want to make that with some of their portfolio, that would provide a little bit of extra return to the investment.

Also, because real estate is not nearly as efficient as the stock market, a lot of people hope to add some value, add some return to their investment through smart active management. My experience with alternative investing really began back in 2012, with peer to peer lending. These are loans that were made to people, they basically came in, they borrowed money from their peers, from these companies like Prosper and Lending Club and they could use it for whatever they wanted. A lot of times it was to pay off their credit card debt. They had credit card debt at 30%, they get alone of 15%. Well, it made a lot of sense to take it. And the idea was that the investor would then make a very good return. So a lot of these notes that you could buy through Lending Club would have a yield of 20% or 22%. And you know some of them were going to default, but you expect that even with the defaults, you could still get pretty decent return. And for years I had a pretty good return it was about 12% a
year but that gradually came down. And part of that was, that a lot of institutional money came into that asset class and really was able to get the really sweet deals out of it, leaving the individual investor kind of pick it at what was left.

And so as my returns decreased to maybe 8% a year, I started looking around going, why would I loan money to people, that’s totally unsecured just to make 8%, when I can go make hard money loans, that’s backed by a real live piece of real estate and make eight, nine, 10, 12%? It just didn’t make much sense to be doing that. And so I basically exited from that asset class, those peer to peer loans. It actually took a while, in fact, technically I’m not even out yet it’s terribly illiquid some of them. There was a way to sell some notes at Lending Club but the demand for them wasn’t terribly high. And so I’ve still got a few of them maybe $1500 worth that I still haven’t exited. And then I’ll probably be holding on for another two or three years.

Plus, there were some shenanigans at Lending Club, their CEO was doing some things you shouldn’t have been doing and it just got to the point where I didn’t like the platform risk and decided if I’m going to be lending money, I might as well get it backed by an asset. I kind of looked at crowdfunded real estate. And both on the equity side and on the debt side and the benefit there, when you go to these companies like Realty Shares and Realty Mogul and Peer Street et cetera, is that you could get into these loans for a relatively small minimum. Maybe it was $2,000 maybe it was 10 or 20,000 maybe at the most, but it was rare I had to put up much more than that. And so on a typical physician income, you could actually do that and get some diversification. You weren’t putting everything into one little loan.

But it never felt very diversified and it never felt very passive. It certainly wasn’t as passive as I would like. I’m spending far too much time, seeing patients and running White
Coat Investor, I don’t have time to be spending hours combing through all these sites trying to decide which house flipper to lend money to and which one not to. And so I started looking a little bit more toward the real estate funds, that would take care of that issue for me. My portfolio as you may recall, is about 60% stocks, 20% bonds and 20% real estate. Of that real estate segment of 5% is in publicly traded REITs, 10% is an equity deals and 5% is in debt side deals. And so as I started looking toward those funds that would take care of this diversification for me and the hassle as well as provide a little bit of liquidity in many cases, I have just gradually moved in that direction.

And part of what facilitated that for me was I just had more money, a white coat investor become more successful in our income and gone up. And all of a sudden the minimums on these funds that might be 50 or 75 or 100,000 or even more just became something that I could actually handle. Whereas, before when I was most in a physician income, I couldn’t really handle that. It was too much for me to come up with, 50 or $100,000 at a time to get into these investments. In an effort to make my investing in these hard money loans, a little bit more diversified and more passive. I first tried a firm called Alpha Flow, and that’s technically a registered investment advisor, they charge 1% a year.

But I was willing to give up 1% in order to be invested in dozens of loans instead of a handful and do not have to pick them out myself and to provide some liquidity on these loans. The returns were about what I’d been getting minus the 1% fee. So this worked out to be something in the 7% range, I think. I had to be an accredited investor already to get into these investments. But once the minimums on those funds became less of an issue for me, I branched out a bit particularly with these hard money loans. I went to a fund called Broadmark. And Broadmark, they have a fund that their first one was up in the Seattle area. Their second one is actually in the Utah and the
Colorado area and that’s the one I ended up investing in. I think I got into it for 75,000. I think their minimum is usually 100,000 but the fact that I had a blog cut me a little bit of a break. But they basically give you a 6% return on those hard money loans and then after that, you split the profits with the fund at 80, 20. You get 80, they get 20. And so that’s been a great investment for me. Over time I have made about 10% or so a year on that and it’s been pretty steady month after month, so that’s been a good investment for me. I also reached out to another fund put on by Arixa Capital which is a firm that does hard money loans in California.

They charge 1.75% per year, which seems really high when you compare it to mutual funds. But you got to bear in mind that you’re not exactly comparing apples to apples there. But they lend primarily in California and it turns out that the California market is a quite a bit more competitive. And you really can’t get quite as high of a yield there as you could in Utah and Colorado, for instance. And so they have both unleveraged fund and leverage fund, I invested in the unleveraged one. And I think again, I ended up with returns in the 7% or so range from that. But I’m always looking for other funds not only to provide diversification, but just to see people who are doing this well.

I mean, hard money lending is not particularly complicated, right? It’s basically house flippers that need cash to fix up a house and then sell the house in six or 12 months. I mean, it’s the same thing that was being done through these crowdfunded sites online. It’s being done by these funds. The developer comes to them and says, “Hey, I need a loan for six months. The higher interest rate doesn’t bother me, that’s just a cost of doing business, but I need to close the loan quickly.” And so they would come to these hard money lenders basically who can close their loan in three days or a week as long as they meet their underwriting criteria. But they weren’t as strict as the bank. They didn’t make you
wait six weeks to get your money. And so that is the proposition here, is these home flippers are coming to these hard money lenders in order to get short term money. But the benefit for these funds is yes, each loan might be short term, but the fund isn’t short term. So over the long run, if you can charge these guys 10 or 12 or 14% interest on the loans, there’s a lot of money there to be made for the investors. The difficulty is, these funds tend to have relatively high minimums.

Even the two I mentioned, I think the minimums are in the 75 to $100,000 range. And a lot of these funds have minimums that might be $250,000 or a million dollars. And this was the dilemma that Alan Donenfeld with CityVest ran into. His brother is an anesthesiologist and Alan told them, “I think you probably have to been investing in real estate. I think it’s the best asset class, I think it has great returns et cetera.” And so his brother went and looked at these private real estate funds and then comes back to him and says, “I did pretty well in aesthetics, I got a multi million dollar portfolio but I can’t get into these funds with million dollar minimums and still be any sort of reasonably diversified.”

Alan looked into solving this problem that people who were accredited investors, meaning they had an income of $200,000 single, or $300,000 married, or investable assets of a million
or more qualified for these investments but couldn’t come up with the minimums. And so what CityVest does, is it forms access funds it basically puts itself as an intermediary between these big funds with a high minimums and the individual accredited investors. And by putting themselves in there and forming this access fund, they can lower the minimum investment for the investors. And sometimes negotiate a little bit better terms. Because they started going to the fund with 100,000 or 250,000 they’re bringing several million to the fund. And so they can often get a price break, better terms, et cetera, with the fund. But most importantly, then turn around to the investor and offer them a lower minimum. Because we’ve not a lot of docs, and come up with $100,000 at a time to invest in a fund like this. Certainly, in the first half of their career, a lot of docs can invest $25,000 at a time. And so that is kind of the CityVest proposition and I discussed on the blog a CityVest investment last December a bunch of people, a bunch of white coat investors ended up investing in it, I did not actually invest in that particular deal. But I think 120 people actually ended up talking to Alan about the investment and I think 44 of those hundred and twenty actually ended up investing, which is pretty good because the time limit was pretty sure is only over a couple of weeks and that was over Christmas. And so those guys got in on that fund.

But CityVest has another fund that they are forming right now and expect to close certainly by the end of March. This is another access fund and the fund that it will invest in is, a DLP lending fun. DLP is the name of the firm and basically this access fund is going to gather up money and form this fund of several million dollars, maybe three, four, seven, eight the goal is 10 million, but I don’t think they’re going to get there. I think they’re probably going to be closer to the six or seven or 8 million mark and then take that money and invest into the DLP fund.
It’s a good opportunity to get into this sort of asset class. DLP has an excellent track record it’s not that long, they only started in the last quarter of 2014 so it’s worked a little over four years now. But their records is very, very good, it’s up over 14% is what they have given to their investors so far, doing these hard money loans. Now, there’s lots of pressure in this space and so it wouldn’t surprise me if the returns were a little bit lower going forward from here. But this fund does well, it’s done well in the past, and every expectation is that it will continue to do well going forward.

Now, this particular fund, the DLP fund is basically an Evergreen fund, right? It’s not a fund with a stop date. But the access fund to be informed by CityVest is. The plan is for this fun to run three or maybe four years. It could possibly be extended another year if all the investors agreed to do it. But mostly this is going to be a three to four year investment. There’s not going to be any liquidity in those three to four years. You can’t get your money out if you need it. But over that time period, the expectation is that it will provide nice solid returns and exposure to this asset class of hard money lending.

So the proposition here if, you go to DLP directly, you’ve got to have a quarter million dollars. And that’s just kind of a big hurdle to get over for a doctor, especially if you want to have any sort of diversified portfolio, especially in my case. I mean, I only put 5% of my entire portfolio into hard money loans and so if I want to have three or four different funds out of that 5%, well, that takes a very large portfolio to put $250,000 in a single fund.

So DLP charges 1% a year basically is what they charge to the investors and everything else that comes in from the fees they charge to the home developers and the interest they charge the home developers gets passed on to the investors. There’s one other fee they charge when you exit the fund, DLP charges a 5%
fee. It’s kind of like a back load that way but I think the idea is to incentivize you to leave your money there long term rather than jumping in and out. So what CityVest did is, they went to DLP, and they said, “I can put together an access fund and the rules on that allow you to put up to 100 investors in the access fund. But we need you to lower the minimums for each of them, basically.” And so what CityVest is offering is a minimum of $50,000 instead of $250,000, you can invest only 50 and that is a nice benefit.

But they also negotiated more, that 5% fee to exit DLP won’t exist for those who come through this access fund and so that is a great benefit. Over five years, that 5% fee adds up to 1% a year so that’s not insignificant at all, it is a major, major benefit to go in through the CityVest fund. Of course, anytime you put somebody else in there, there’s going to be some additional fees, right? CityVest charges, three fees. The first one is a one time fee that is spread over all of the investors in the fund. This is a $50,000 basically set up the fund fee. And so depending on how much money is invested in the fund, it depends on how much of a fee that really is. If $5 million gets invested, that’s about 1%. If $10 million gets invested, that’s about .5%.

The second fee is charged each individual investor, it’s $500 a year. And that’s basically to cover the costs of running the fund here. And that works out to be about 2% a year, if you invest $25,000, or if you invest $50,000, that’s about 1% a year if you invest $100,000 it’s .5% a year. So it depends on how much you invest, it depends on how high that fee really is for you.

Then the last fee is .75% a year paid to CityVest. So in exchange for those fees, what they do is they give you a lower minimum and they manage to get that 5% exit fee waived for you. So that is basically the proposition CityVest is making. CityVest comes to me and says, “Hey, I need some more investors, you know a lot of doctors, if you refer me doctors,
we will also pay you, and out of what we earn off those fees from the doctors.” So I said, “Well, that’s great. But at each step, I want there to be value added for the investor.” And so the value I was able to negotiate with CityVest was to lower that minimum from $50,000 to $25,000 for you.

If you come through the links that we’ll put in the show notes, you can invest with only $25,000 into this fund. The other concession I was able to get from CityVest was a decrease in that 0.75% annual fee for the first year, that fee will be cut in half. And so that’s the incentive for you to come through my links rather than to go directly to CityVest and to invest in that fund. Even after those fees, if this fund makes the 14 and a half percent it’s been making, you’re still going to be making 10, 11, 12% in that range. It’s an excellent return for hard money lending fund. I mean, look at the Broadmark fund. I mean, I’m making 10 something percent on it. Look at the Arixa Fund, I’m making seven or 8% on that. Look at the Alpha Flow, I’m making seven or 8% on that. So yes, you’re paying some fees there but even after fees, your return should be good enough to be worthwhile invest in there.

So what’s the difference between this fund in some of those other funds? Well, instead of lending in California or Utah or Colorado, this DLP fund lends primarily in Pennsylvania, Florida with a little bit in New Jersey. And there’s some things about both the types of houses that they lend money to, they’re being developed. They’re a little bit C and B class houses rather than A class houses, cheaper houses basically that allows them to charge a little bit more. And frankly, there just aren’t as many people doing these loans out in those states as there are in California, as that allows them to have these high returns.

So I expect I’m going to invest in this deal as well. I haven’t decided how much I’m going to put in, obviously, the minimum will be 25,000, but I suspect I’m probably going to be closer to the 50 to $100,000 level just because I want to
minimize those fees that get minimized. That $500 per investor fee, is much lower as a percentage of the return if you invest 100,000 verses 25,000. Also, the incentive of course, is to get as many investors in the fund as possible. And I don’t think we’re going to have trouble getting the maximum 100 in there but to have each of those 100 invest as much as possible because the more it’s invested in the fund, the more that initial $50,000 fee is spread out over and lowers that fee relative to the entire investment.

If you would like to join me on this investment or learn more about it. There will be links in the show notes and you’ll be able to go to CityVest and talk to Alan Donenfeld and go over the paperwork and ask him any questions you want to about the deal and learn more about it. I’ll be talking about a little bit more on social media, maybe even on the blog a little bit in the coming weeks, but that’s basically the explanation of the deal. Okay, make sure if you want that special deal to be able to only invest 25,000 or to get that half of your first year’s fee waived that you let them know you came from White Coat Investor, otherwise you won’t get that.

Okay, let’s get into some of these SpeakPipe questions. Our first one comes anonymously and here it is. My question is about having a one time lump sum and how you treat it. There’s a ton of consolidation in healthcare today across multiple specialties. Along those lines, my rather large specialty practice is purchased by a private equity group to create a new practice management venture along with a few other founder practices. And my questions are both philosophical and practical. First, how would you count the proceeds from such a one time deal as it pertains to adjusted gross income for the given year? Let’s just say to use around numbers that the buy out for physician was a million dollars plus another $500,000 in stock in this new venture, would you separate this one time payment out from your adjusted gross income or would you lump it all together?
So for instance, if you made $500,000 in 2018, would you say that you did make 1.5 million or would you count this as a separate bag unto itself? And then secondly, how would you approach a sudden windfall like this? We are planning to invest almost all of the actual proceeds those dollar figures which is made up, but we have been slowly doing it, paying taxes and whatnot, but I’m just curious how you would approach utilizing that money?

Basically the question here is, what do you do with a million dollars plus $500,000 in stock? How does that affect your adjusted gross income? Should you treat as a separate bag or just part of your income? Well, I’ll tell you this, the IRS is going to treat you as just part of your income, so you might as well do that. And when you’re using tax terms like adjusted gross income, that’s what we’re talking about. We’re talking about your adjusted gross income. And if you make the money in that year, you got to pay taxes on in that year.

But just philosophically, anytime you make money, it all really goes into the same pot, no matter where the money came from. Whether it came from your investments, whether it came from your spouse’s income, whether it came from your income, whether it came from inheritance, it’s all money, right? It’s all fungible and you ought to treat it all the same. That’s just a common behavioral mistake that people make to treat it as some separate amount, just because you had this windfall coming in, you got to do something different with it and that’s not necessarily the case.

So the second part of that question, however, was what do you do with a windfall? Hopefully, everybody listening to this podcast will get some sort of a windfall during the course of their life. You don’t know how much it’s going to be, you don’t know when it’s going to come but chances are, you’re going to receive something that maybe you weren’t expecting. And that’s really my definition of a windfall. But there’s really three categories of windfalls. The first one is the one
I call spare cash, right? This is money, maybe $10,000, maybe $200,000 that you weren’t expecting. And I would just take that money and kind of fold it into my existing financial plan.

Maybe you’re working on paying off student loans or paying down a mortgage, you’re trying to max out retirement accounts or putting money towards your kids’ college, you’re trying to save up for a new car, whatever. I just take that money and divide it among my goals in whatever manner I see fit, I’ll try to minimize interest and decrease taxes and maximize your returns. So early in your career, it’s probably going to go towards student loans, in your 50s maybe it all goes toward your mortgage, but most likely it’s going to be split among all the different financial goals you’re trying to accomplish, just like any other money you made, like your monthly paycheck.

The second category is what I consider enough money to make you financially independent. Maybe this is an inheritance of one or 2 million, it’s really enough to change your life in a significant way. And this is kind of the amount that this doc was talking about in the question. The best thing to do upon getting that level of money, is probably nothing. Do nothing for a few months, or maybe even a year, give it some time and really think about what you’re going to do with your life. If you’re ready to retire already, go ahead and do so. If you want to get out of medicine, write books, you can do that too. If you love what you’re doing, maybe you put a chunk toward retirement, give some away and you spend some, all right?

The third category is what I call ridiculous money. Okay, this is when you get a windfall like a lottery winnings, which if you invest it wisely there’s more money than you could ever spend given your current lifestyle. Okay, it might sound similar to category two, but is different in a few important ways. At this point, you’re going to need to engage in some pretty serious estate planning for instance. And you have a
real opportunity to make change in your community and in the world. So this is a responsibility that you can’t take lightly. You’re also going to have the hordes coming after you, both family members and just random people if they find out you received a windfall like this.

It makes me think about what Andrew Tobias recommended in the only investment guide you’ll ever need. Here’s what you said you should do if you win a million dollars. He said, “Go out for a very nice dinner, put about one year of normal living expenses someplace liquid like a bank or money market fund, and then put roughly equal sums into US Treasury securities, maturing to one, two, three and four years. Then put the bulk of the remaining money into stock index fund split between US and foreign investments. Buy a bigger house if you want one, but not so big that the cost of carrying it will strain you in any way. Maybe even consider buying a small rental property but don’t buy a boat is what he says. Make sure your will is in order and then relax and forget the whole thing.

That’s Andrew Tobias’s advice and I think that’s pretty good especially the advice about not doing anything quickly. Now if you just inherited ridiculous money, try not to let anybody know about it, right? Because then you’re going to have the hordes knocking on your door. Another consideration, I think, is to actually consider annuitizing some of the money, right? You hear about all these lottery winners they go broke. Well, you can’t go broke if you ended up annuitizing it such that it’s going to pay you out a certain amount every month from now until the day you die.

It’s also a great time to get some solid unbiased advice. Talk to a CPA for some tax advice. Maybe an attorney from estate planning and asset protection advice. Pay him a fair hourly rate, rather than some percentage of your windfall, pay off your debts. I mean, if you’ve got some big inheritance, what’s the point of lugging around a bunch of little debts anymore? Get rid of them. And then put a big chunk of the money into
safe investments, CDs, bond funds, money market fund, et cetera. You have a much lower need to take investment risk than you did before the windfall. So take advantage of that by taking less risk.

Then I think it’s important to do a couple of other things. One is spend some of it. You just had a big windfall, this is like a diet, right? If you never break your diet, if you never loosen up just a little bit, you’re probably going to explode and the diets going to fail. So spend at least a little bit of money, right? Don’t go crazy, buying some massive yacht or something, but spend a little bit of the money. And then give some of it away, maybe some to your family but mostly to real charities they’re going to do some good in the world. I think that helps you keep money in the proper place in your life. And of course, remember that one of the benefits of having enough money is that you don’t have to maximize everything out.

You can use this to worry less about money because you have more now. I think that’s what you ought to do, if you get a big windfall, and whether that comes from selling your practice or whatever, it’s really all the same. Bear in mind one difference with selling your practice, particularly to some of these corporate management groups, is that it often comes with a lower future income. You’re trading a lump sum now for a lower income later. And so you got to keep that in mind, if you’re going to be making less money going forward, you’ve got to plan your lifestyle going forward on less money. And so in that sort of the case it’s important, but most of that windfall toward retirement. Okay, our next SpeakPipe question comes from Kelly.

Hi, my question is coming as the wife of a doctor who is just finishing his fellowship in pediatric anesthesia. He’s going into academic medicine, he just signed his contract to start at an institution this Fall. He will be going for student loan forgiveness and is on track right now to have the debt
forgiven in about five years after he starts the attending job. My question is, what are some of the things that we should be thinking about and considering to do the math, if you will, to see if we can afford for me to quit my job and become a stay at home mom?

We have two young kids, we currently have a full time nanny for them and I work. But I would love to have more time with them, especially for the next couple of years when they’re very young. But I want to know, what are not just kind of the short term things that we should consider in terms of the impact on our finances, but also what are the longer term things that we need to be thinking about in terms of how it could impact our retirement and what not, insurance needs and things like that? So without going into specifics here, we would just love some general guidance on how to think about it.

As you heard, Kelly’s husband is a pediatric anesthesiologist coming out of fellowship. He’s an academic, he’s going for public service loan forgiveness. And her question is really what do we need to do to decide if we can afford for me to quit my job? They’ve got a nanny, and she wants to quit but is a little bit worried about both the short term and the long term issues behind quitting. I think this is actually really common, particularly in the traditional scenario where the guy is the doc. He has been plugging through medical school and residency and fellowship and been supported by his wife, while they may or may not be having children as well.

And so this is probably a pretty common question and pretty common issue to deal with. But there’s a few things to consider. First of all, this doc is going from a fellow salary to an attending pediatric anesthesiologist salary, all right? There’s no doubt in my mind that if they keep their lifestyle under control, she can certainly quit, walk away and never work again. Let’s be practical about this. He’s going to have enough income to take care of business, to save up enough for
I didn’t make anything near what pediatric anesthesiologist would make when I came out of residency and there was certainly plenty of money there as my wife did not have to work. If you don’t want to work, I don’t think that’s something that necessarily has to be done. But are there consequences? Sure, consequence number one is your income is not going to be as high as it would be if you continue to work. No doubt, right? And so that’s an obvious impact, it’s going to be a little bit slower to reach your financial goals. It’ll take a little longer to pay off student loans and save up a house down payment and buy that new fancy car you want or become financially independent, whatever your financial goals may be. But there are a few other issues as well, you might not have thought about.

First of all, the income drop might not be all that much. Kelly didn’t mention what she does for a living. She might be a physician making $400,000 for all I know. But one savings you will definitely have, if you’re coming home to take care of kids is you won’t have to pay the nanny anymore. And so there is some savings there and when you actually look at the taxes you pay being the smaller second income in a family, oftentimes it is really not worth continuing to work at all, when you calculate out your hourly rate. Once you include the cost of a nanny and you include the cost of the additional taxes and all those kinds of things, that can go away when you are working at home.

That’s an issue there but there are a few other issues. One, if you’re no longer working, you are going to probably want to have a little more life and disability insurance on the breadwinner. Now it’s not a bad idea to have some life and disability insurance or at least life insurance a little hard
to get Disability Insurance I suppose if you’re not making an income. But some life insurance on the person who is being a stay at home parent because what they’re doing has real value and you can calculate the economic value of it just look at what a nanny costs and a housekeeper costs and additional meals out costs and all those kinds of expenses that would have to be paid if there was not a stay at home parent.

But probably the most important long term issue here is the effect on her career, because when you take significant time out of the workplace, chances are your long term earnings are going to be lower and it will be harder to get back into the workplace. And you will probably not be as far along in your career as somebody who spent more time in that career rather than taking time off to raise a family and it might be impossible to get employed at all.

You get out of medicine for more than a few years and it’s almost impossible to go back in. Nobody’s going to want to license you, no one’s going to want to give you privileges et cetera. And so you have to be really careful I think probably the biggest thing to be careful about here is the impact on your career. If you’re sure you’ll never go back to it no big deal. If you think you might you may want to look into part time work, you may want to look into some way to keep your skills up. Okay, let’s take another SpeakPipe question this one from Michelle.

I’d love to hear you do a podcast on how you teach children ages three to 23 how to be financially literate, unspoiled and charitable. That’s a tall order, it’s difficult. But I think there’s a lot of things you can do. I think the financially literate part is the easy part. It’s relatively easy to teach your kids about money once you understand it yourself. We start very young. Our three year old the other day was playing monopoly with our nine year old which was always interesting to see. And she said she wanted to buy a property and the nine year old
explained to her, “Well, you’re going to have to go into debt to do that.” And so she did and then she started crying, “I don’t want to be in debt.” And so you can start pretty young teaching people about debt.

I make my kids listen to Dave Ramsey on the radio. Sometimes when we’re driving around in the evening to their activities. And they all scream and cry about it. “No, we want to listen to something else.” But you know what, in the end, some of those lessons are being absorbed, and they’re learning to pay attention to finances. They’re learning about the dangers of debt, they’re learning about retirement accounts, they’re learning about investments. They’re learning about these things that are important. But I talk to them about finances all the time, as you might imagine. I mean, you’ve seen some of Whitney’s writings on the blog and I think as the other kids get older, you’ll probably see some writings from them as well.

But the financially literate part I think is relatively easy. You just got to talk to your kids about money and teach them about stuff. And you’d be surprised this stuff is not that complicated. A lot of it can be learned at relatively young ages. You can even give them books, there some books that are written specifically for kids and you’d be surprised they find they’re interesting. All of my kids are gone had some sort of entrepreneurial pursuit, it might be a lemonade stand, they might be shoveling driveways for somebody else. You also have opportunities, I think, at times when they’re trying to raise money for something. You tell them, you’re going to have to earn a certain percentage of this yourself. For example, in June, Whitney and I are going to Honduras on a medical mission. And she wants to go along and I told her, she had to raise a certain amount of the money to be able to go along. And so she’s coming with up with all kinds of ways to raise money. And so I think it’s good to teach them a little bit about entrepreneurship that way as well.
The other two questions unspoiled and charitable, are a lot more difficult. Let’s take the charitable one first. One of the things we do is we give away a lot of money. As you know, if you paid attention to the blog the last couple of years, we’ve given away more money than we spent and we’re proud of that, but we want to pass that value on to our children. And so once a year at least we have a family meeting and decide what charities we’re going to support with our money that year.

And each person in the family gets an equal say, and we go around and we battle it out. And you have to argue for your favorite charity. I wasn’t able to talk anybody else in the family into donating to the access fund this year, which is a charity that basically helps keep climbing areas open. But we end up donating to other charities instead. And so I think I actually involving them in the family finances in a way that’s appropriate is also a great way to teach them to be charitable. Not only money though, also with time, and you can take them out and do service projects and those sorts of things with your children and teach them to be charitable.

It also helps I think, particularly when traveling to point out that not everyone has the advantages and opportunities that they have, which kind of segues us into the unspoiled section. And this is the big challenge I think when you start making decent money, particularly way money than either of you grew up with, is keeping your kids from running into being spoiled. And I don’t think I have all the answers on this one for sure. But I think some things that you can do are to maybe limit what they have. Just because you can afford to send them to school in a Range Rover doesn’t mean you should. Just as you can afford to buy them a $6,000 purse doesn’t mean you should, just because you can afford an iPhone, maybe they should have a flip phone until they reach a certain age. And so I think maybe artificially limiting how much money they see in their lifestyle is beneficial to them. It also helps to
talk to them about the times in your life when you really didn’t have that much money. I’m constantly reminding my kids that when they turn 18 and get their own car and their own house and their own job that they can do whatever they want and until then they have to follow my rules. And so that’s kind of a constant reminder to them that at a certain point in their life, they’re going to be responsible for themselves and have to live on their own income.

I think it’s also important to make sure you don’t give them too much money, particularly earlier on in life to ruin them. I mean, most of us make enough money that we can truly ruin our kids and so I think you have to be really careful how much and how you pass that money on to them. And hopefully as they prove that they can use it responsibly you can give them a little bit more. Okay, our next question comes from an anonymous asker let’s take a listen.

You always speak of buying the cheapest term life insurance policy one can get at places like term4sale.com. But when I purchased my own policy I worried a lot about the financial health of the insurance company, especially when one buys a term of 20 plus years. After some research on my own I found a Comdex ratings and a solicited quotes directly from the top four to five companies with ratings above 95. And ended up buying a term policy from Northwestern Mutual. What role do you think the Comdex ratings and all the ratings such as customer service responsiveness should play in docs deciding on which policy to buy? Should a young doctor worry about getting a policy from financially sound companies only, even if they cost a bit more? After all, if something were to happen, you’d want them to actually pay out.

Basically, this questioner is asking how much does the strength of the insurance company matter when it comes to term life insurance? And I think it matters. I don’t think it matters as much as a lot of insurance agents think it matters but it’s worth looking at. So he mentions a site that’s
actually an advertiser on my website term4sale.com. It’s a great place to get life insurance quotes without giving them any personal information and being able to compare them. But I think an interesting exercise can be done by going to that site and actually looking at the ratings for these companies. So these companies are rated from A++ plus which is superior to F, which is in liquidation and everything in between.

There’s A++, A+, A-, those are basically superiors, superior, excellent, excellent. And the default on the site is that they only show you companies that are excellent and up, so you’re either superior or an excellent. If you want, though, you can look at companies that are very good, which are the Bs or adequate, fair, which are the Cs very vulnerable, which are the Ds, right? So you can go as far down that list as you want to. But an interesting thing you’ll notice if you adjust that and look at the options that term for sale gives to you. For example, if you ask for only the very top rated companies, the A+ pluses, the one it will come up with at the top of the list. And I will just put in, basically my birth date, a 30 year level term policy for a million bucks. It comes up with $1,000,532 a year. And it’s interesting if you just go with a default option the one that comes up at the top is Cincinnati Life Insurance Company, which is $1,415. It’s about $117 less you can save by going with a company that isn’t the very top rated company, so that’s pretty good. I went ahead and I put in basically, I let them go down as far as I think it was B- or so, which is still okay. But what turned out to be the best company? Well, it was Cincinnati still.

And it turns out that if you look at this list, the TIAA-CREF is the very top rated one that comes up here at $1,532. But in the very next category is Lincoln at $1,483 a year and in the third category is Cincinnati with $1,415 a year. And so even if you go way down the list, the cheapest company is still going to be Cincinnati which is A rated. I don’t think this is really a big issue in practicality, you’re not going to go to
a D company or an F company or probably even a B company. But is it worth dropping down below A plus plus to save 100 bucks a year? I think it probably is. I’d be comfortable with anything that’s rated A or higher on that and wouldn’t think twice about it. I think it’s fine to just use the default, the term for sale users for quality in the company. But if you’re really worried about it, pay another hundred bucks a year and get one of the very top rated companies.

Okay, I wanted to go over a little bit of feedback. We got the first one is from Podcast 85. Jim I want to say, Podcast 85 is fantastic. I love the format with regards to interviewing a doc and delving into the details their financial life. I was surprised to hear you say that medicine is more insulated from financial conflicts of interest because of the opaqueness of insurance reimbursement. Personally, I feel like I’m wrestling with the devil on my shoulder every day with the record to conflicts of interest.

I’m an academic vascular surgeon. I’m on a contract that is heavily dependent on RVU generation. This seems to be the norm in many academic and employed contracts. When I do a lower extremity angiogram, a diagnostic procedure reimburses, 4.5 RVUs this increases by 100% if I do an angioplasty and 150%, if I do an atherectomy. To make matters worse, there’s little time difference in any of the above and murky data to guide therapeutic modality choice. I’m constantly weighing evidence bases medicine and best practices against that little voice telling you to earn more. I can’t imagine I’m the only one out there with this feeling, in fact I’ve heard docs joke that Dr. So and so doesn’t participate in non RVU generating activities.

I’d love to hear more discussion about this because I think these sorts of production contracts are becoming so ubiquitous. Yeah, certainly, there are ways in which you can have conflicts of interest in medicine without a doubt. And I think this surgeon describes about as bad as they get.
example, if you are on a salary, just a flat salary, say you’re a military doc, a VA doc, whatever, there’s basically no conflict of interest there whatsoever. In my group, it is not completely eat what you kill, but we are the business owners. At the end of the day we split up what’s left and divide it by how many shifts you worked in that month. And so that insulates you a little bit from the day to day decisions. Yes, you know that if you do things that bill more, you’re going to make more money. But since the group has 18 docs in it, every little decision you make, you’re really only getting 1/18th of the difference in that additional money that comes in from making a decision one way or another. And I think the conflict of interest there is much, much smaller and much easier to resist, than if you are 100% based on RVU compensation. I think that’s actually kind of a minority of doctors that are 100% RVU based. And so I think comparatively to a lot of other professions, your conflicts of interest are much smaller. Are they invisible? Obviously not. And this doc has given a great example of when they are not.

Also, I got some feedback from Podcast 86, regarding your podcast 86 on concentrated single stock holders in taxable accounts. There’s another way to diversify a single stockholder without selling donated and gifting the shares. It involves using an exchange fund and this here is right to point this out. This is true, this would have been a good thing for me to mention. He says, “It’s relatively unknown among most investors and typically requires a significant single stock holding like a half million or more, but exchange funds allow you to contribute your single stock into a pool of other stocks formed by the exchange fund, then when you withdraw your capital, your single stock holding converts into a basket of diversified stocks and often some real estate by law from the pool without triggering capital gains taxes.

Obviously, there’s fees pays to the exchange fund that makes the magic happen, he says Eaton Vance provides one of these
funds. So this is another way to basically flush capital gains out of your portfolio. Maybe that’s not the best way to put it. Rather than flush capital gains out what you’re doing is you’re achieving diversification with the same amount of capital gains. So that’s one other option to do if you’re trying to get rid of a very concentrated holding and diversify your portfolio a bit.

All right, this one’s gotten a little bit long so we probably ought to start wrapping up here. Our advertiser, our sponsor for this podcast is WealthKeel who utilizes a simple flat fee structure to offer both financial planning and investment management as well as project specific hourly advice. Chad, is a certified financial planner and fiduciary for physicians and their families. He’s been quoted by medical economics, the American Medical Association and CNBC for his work with physicians. Over the years countless WCI readers, both delegators and do it yoursers have trusted Chad and his team at WealthKeel for ongoing financial planning and one time plans. To learn more and to schedule your free icebreaker call, visit wealthkeel.com/WCI or email Chad directly at ChadChubb@wealthkeel.com.

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8 Essential Traits of a Good Property Manager

[Editor’s Note: This WCI Network selection comes from Passive Income, MD and is all about how to find the best property manager. If you’re going to own real estate directly, finding a great manager is essential — You really don’t want to end up with a second job collecting rent and taking 3 am phone calls, do you?]

We want to invest in more “passive” income, where we can create wealth in our sleep–or at least while we’re enjoying time with our families and on our hobbies. Owning a rental property doesn’t sound so passive when the phone rings at three in the morning.

Instead, would-be real estate investors often find themselves opting for real estate funds, REITs, crowdfunding, or another (less hands-on) form of investing. I think all of these are great options, and I’ve found myself heavily invested in those as well.
However, I believe that owning properties is an amazing vehicle for developing long term wealth. I’ve seen it in the lives of some family members, friends, and a good number of financially-free physicians.

I’m sure you would agree that the idea of owning rental property is great—at least, in theory. But in reality, how are we supposed to own a rental property but still have the time to pursue our jobs, travel, spend time with our loved ones, and golf?

The key is simple: Find good property management. Sure, you could manage that property on your own, but is it worth it? In most, if not all, cases, I believe that you should leave the hands-on management up to someone else and free up your time. After all, your time is the most valuable resource.

Finding a good property manager is easier said than done, however. How can you find one of the good ones? What’s the evaluation process? Well, I’ve compiled a few essential things to look for when you select one for your property:

**How to Find the Best Property Manager**

**Experience**

This one is pretty obvious. You want someone who knows how to handle things properly, so they’re not calling you at the slightest issue. Find out how long they’ve been managing properties and the number of properties and/or units they have in their portfolio.

Ask them how they handle tenants who pay late, how they handle tenant complaints, and what they do with known troublesome tenants. They should also understand local laws when it comes to regulations, evictions, and standard operations of the
Extremely Detail-Oriented

I’ve dealt with a good number of property managers in my relatively short time as an investor. Finding someone who focuses on the details is crucial.

Running a business, which is what owning rental property is, requires every penny to be tracked and documented. After all, when it comes to tax time, the IRS wants that information. Will your property manager hand you poorly-written expense reports? Would they calculate the net operating income accurately?

Not only will this characteristic help both of you in the day-to-day tasks, it’ll be immensely beneficial through in the future, even if a different manager takes their place at some point.

Organized

Going hand in hand with the last point, finding a property manager with good organizational skills will save you some major headaches. If they have a clear process for even the little things (collecting rent, screening potential tenants, resolving maintenance issues, etc), you can be much more
confident in their ability to handle larger things when and if they arise.

Also, if you have a business-related question, especially around tax time, an organized manager will be able to answer it. This is your business, so finding someone with this trait will help ensure it runs smoothly.

**Fair Fees**

This is a big one. The whole idea of having a property manager is off-putting to a lot of potential investors, largely because it implies a sense of reduced profits. Having to pay a manager means you’re limiting your returns, after all.

Well, I just consider it a standard expense when I look for a rental property. I make my projections on returns based on an expected management fee and make sure I’m happy with that before purchasing the property.

What is the standard management fee? Well, it varies according to the type of property you have. I’ve found that if it’s a single family home, management fees tend to run 8-11% of the monthly rate. For multifamily, they seem to run from 5-8%, depending on the size of the building. Again, make sure you ask for a full fee sheet because typically, there are so many additional fees for example when there is tenant turnover or even when there’s rehab.
Good with People

I’ve found this to be extremely important. Not only is your property manager the manager of a building, they’re also an organizational leader. Trust me, if your tenants can’t stand your property manager and the way they talk to them, they will consider leaving. It’s happened to me.

Tenant turnover can be a killer on the bottom line - especially when you lose good, reliable tenants. Find someone who has a good demeanor. Fortunately, whether or not they have this characteristic should be pretty apparent after a few face-to-face meetings.

Communication Skills and Responsiveness

Have a property manager that’s hard to get on the phone? Right off the bat, that’s a major red flag. Communication is everything in this business, and the property manager is basically your eyes and ears when you can’t physically be at the property.

You’ll find a good property manager will communicate immediately (when appropriate). They may handle it themselves first, but they should make you aware.

Finding yourself leaving tons of messages and sending emails before getting a response is not what you want. It may be that they’re bad communicators or they just have too many properties to manage. Whatever the case, if you’re not getting the response you need, you’ll be in for a bad time.

Tech Savvy
There have been a good number of advances in technology that have made the lives of both tenants and managers way easier. Online rent payment options, portals for tenants and managers, and online maintenance requests have made communication simple. As an owner, I now really appreciate having some sort of portal that I can log into to check my statements. Still, that last part isn’t a deal breaker for me, because having a manager who is good at reporting can make up for the lack of a portal.

However, it’s still nice to ask if they use a management system that allows you to do so (like Appfolio). Many tenants would even rather pay online than dropping checks in the mail. It’s a convenience thing, and the more convenient you make it for the tenant to pay their rent, the better.

**Patience and Willingness to Teach**

If you’re a novice property owner, having a manager with the willingness to explain things is an invaluable asset. Believe me, I’m still learning how to be the best owner and how to make effective decisions.

I’ve asked my property management a good deal of questions, trying to understand certain things, like why they patched something instead of replacing it, or why they set up their leases a certain way, or what their process for dealing with
trouble tenants is. The list goes on.

Bottom line: They should be patient with you and willing to teach you.

**Conclusion**

I’ve made mistakes in hiring a property manager and I’ve definitely seen how that can affect the way your business runs. A good manager has to wear many hats. They must be handy, they have to be knowledgeable, and be good with people (for better or worse). All of this comes from experience, yes, but it also takes the right kind of person.

I’ve rushed to find property management in the past, and I’ve paid for it with unhappy tenants, poor accounting, etc. It’s not fun. However, it took those situations for me to understand what makes a good property manager, and it made me realize that I shouldn’t compromise.

The tough part is discovering these traits before you hire them. Do this by asking for examples of accounting, what procedures and policies they have in place for other buildings, and paying attention to how they interact with you. In fact, don’t be shy. Tour another property that they own. Call those landlords and find out how happy they are with the management.

I believe this part is just as important as finding your
building. You need someone capable and competent to run not only the building but your business. They are your connection to the tenants and they need to handle that effectively.

Property management will free you up to what you wanted in the first place: enjoying time with your families and collecting that passive income.

Do you self-manage your properties or do you hire property management? Comment below!

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**Should You Invest in Real Estate Over a 401(k)?**

**Q. Should I Skip Investing in a 401(k) in Favor of Real Estate?**

I am a 4th-year medical student applying to residency and my initial plan is to do a [Roth IRA](https://en.wikipedia.org/wiki/Roth_Individual_Employer_Pension) and [invest in real estate](https://en.wikipedia.org/wiki/Real_estate) during my training (I have always had an interest in real estate and have been blessed enough to have successful mentors in that area). My goal is to build wealth, pay back student loans, and establish financial independence. However, I am not sure what to do about [retirement accounts like a 401(k)](https://en.wikipedia.org/wiki/401%28k%29) when I finish residency and get my first “real” job. I have been reading lots of information on tax efficient ways to build wealth and, ironically enough, much of the information I have read think that investing in a 401(k) is a bad idea, especially when there is no match.
Tom Wheelwright (the tax advisor to Robert Kiyosaki who is the famous author of *Rich Dad, Poor Dad*) is vehemently opposed to a 401(k). In his book “*Tax-free Wealth*” he states that investing into a 401(k) is actually unwise for anyone seeking to build wealth for the following reasons:

**Investing in a 401(k) causes you to pay a higher tax rate on the profits from your investments.**

Outside of a 401(k), capital gains taxes from stocks are 15%, but if people retire rich, then their tax rate might actually be higher than 15% and their marginal rate might be over 20% as they withdraw money from the account. Since they deferred taxes by investing into a 401(k), once they withdraw money during retirement, they will not be able to pay the lower capital gains tax of 15% on their 401(k) profits. Instead, he/she will be forced to pay taxes on all the money they withdraw at the higher income tax rate.

**Investing in a 401(k) decreases your returns since you cannot invest using leverage.**

Unlike investing in real estate, where people can use leverage in the form of a mortgage to purchase more homes or investing in a business where people can use debt to purchase equipment or leverage their time by hiring employees, a 401(k) doesn’t offer that flexibility. He states that it’s much harder to invest using leverage inside of a retirement account and this
limits the types of investments one can make and thus lowers the returns they could have otherwise received. The example he uses is the limitation on what real estate deals one can purchase inside of an IRA vs outside of one.

**Investing in a 401(k) Decreases Control**

Investing in a 401(k) decreases the control you have on your investment since there are so many restrictions associated with them. The government has many rules on how much you can put in it, when you can take the money out, and what types of investments you can make inside of it.

To summarize, he recommends against putting money into a 401(k) since it only offers temporary tax savings and has many negative consequences such as the three listed above. He states that those who are seeking to build wealth and permanently lower their taxes should instead invest in things like businesses, real estate, commodities etc.

What are your thoughts? If you still advise that people invest in a 401(k) (even when there is no employer match), what is your reasoning? How do we combat the higher tax rate, the government restrictions, and the inability to use leverage to realize higher gains? I understand that this email is quite long, but I would love to hear your thoughts.
A.

This reminds me of a post I did in 2017, titled In Defense of the 401(k), and in fact, the original name of this post was “In Defense of the 401(k) Part 2” until my editor pointed out that title had almost zero SEO value. Alas, the things we do in search of web traffic. So, I hope nobody thinks the title means I think real estate is a bad investment. I do not think that and have plenty of money invested in real estate myself. However, I also max out my 401(k)s.

It seems this tax-advantaged investing account is a frequent boogeyman for real estate investors. Like many of the arguments in this email, I think that’s a little silly. Like I did in part 1, I’m going to deconstruct the arguments, point out where they’re wrong, where they’re right, and where they’re simply a half-truth.
Kiyosaki Is No Real Estate Authority

First, let’s start with the obvious, at least obvious to those who have been in the personal finance sphere for a while. Robert Kiyosaki wrote a best-selling book(s), but it was based on a lie and has been heavily, accurately, and appropriately criticized. Every Kiyosaki fan should be aware of these criticisms, probably best expounded by John T. Reed. Needless to say, once you read that, you’ll be far more skeptical of anything and everything Kiyosaki says, much less his tax advisor. It’s not that there is nothing useful in his books, but don’t treat it like scripture.

Residents Make For Lousy Real Estate Investors

Second, let’s go ad hominem (just a little.) You’re a fourth-year medical student and sent me this letter in November. Now I’m all for learning some finance and investing in medical school, but my recollection of November of MS4 was that it was all about matching into a residency position. You’ve already invested 7+ years into becoming a doctor, and have at least 3+ ahead of you. A career in real estate is very much a viable path to wealth, but it doesn’t seem to be the path you are on. A typical resident has neither the time nor money to be a successful real estate investor and I worry that spending a lot of time on that goal would affect what I think ought to be your primary focus – becoming a good doctor. Tell you what, come back in a half decade or so after you have completed residency, paid off your student loans, and built up a little capital to invest and let’s talk.

Seriously though, all a doctor has to do to become wealthy is learn to practice good medicine, live like a resident for 2-5 years after residency, save 20% of gross for retirement the
rest of her career, and invest it in some reasonable mix of stocks, bonds, and real estate. That doc is highly likely to retire with the equivalent of a mid 7 figure portfolio today, which will provide a physician level of income throughout retirement. Anything above and beyond that is a bonus. Lots of docs have done just fine with real estate and I don’t want to discourage you (probably couldn’t even if I wanted to.) It’s great. But it’s not a reason to hate on 401(k)s. There are many roads to Dublin. If you prefer real estate to stocks and wish to make your portfolio 80% real estate (the opposite of my 20% position), I think that’s fine. If you want to buy one property a year after finishing residency, I think that’s fine. But I see little reason to take an extreme position in the stocks vs real estate debate.

Real Estate Investors Don’t Like 401(k)s

Third, if the authors of all the books you’re reading don’t like 401(k)s, maybe you’re not reading the right books, or at least not all the right books. If all the books you read say the same thing, you probably ought to broaden your perspective a bit. May I suggest a book or two from a Bogleheadish perspective? Maybe something that talks about the benefits of
The Tax Advantages of a 401(k)

Fourth, I’ve been surprised at the pathetic understanding of the tax code among many real estate investors. Somebody in some seminar or book somewhere told them that real estate is awesome for taxes and retirement accounts suck and they just believed it without actually learning how the tax code works. Let’s talk for just a minute about the tax benefits of a 401(k).

#1 Tax-Protected Growth

The investments in the 401(k) kick out income and you occasionally sell something with a gain and buy something else. You don’t pay taxes on any of that as it grows.

#2 A Big Tax Break

The second benefit is a big fat tax break the year you contribute to the account. In fact, this is the biggest tax break available to a doctor. My practice has offered a 401(k)/PSP ($56K in 2019) and a DB/CBP ($5-120K in 2019) allowing $61-176K to be protected from taxation. At my 42% marginal tax rate, that could knock as much as $73,920 off my tax bill once I am old enough for that $120K/year contribution. For each year I contribute. That’s hardly insignificant, but wasn’t even mentioned in your email and presumably in Mr. Wheelwright’s book.

#3 Withdrawing at a Lower Tax Bracket

The third benefit is the opportunity to do Roth conversions or withdraw money in your lower income years. The idea here is to defer taxes from high-income years to low-income years. For most docs that aren’t super savers, they’re going to be able to withdraw or convert money at a lower tax rate than their
rate at contribution at some future date. That might be as they phase out of their career. It might be in early retirement before they start taking Social Security or have to take RMDs. It might even be in later retirement. Most docs drop a couple of brackets or more when they retire, so even if the brackets inch up a bit, they still come out ahead. In addition, especially before taking Social Security or for someone without a pension or a bunch of rental income, they can use those tax-deferred withdrawals to fill the brackets. $24K standard deduction? That’s $24K that comes out tax-free. Contributing at 42% and withdrawing at 0% is a winning combination. The next $50K comes out at 12% and nearly $100K comes out at 22%. Win, win, win. This dramatically trumps the benefit of the lower capital gains rate (which isn’t always 15% by the way. For me in my state, it’s 28.8%. Lower than 42% yes, but not quite as awesome as it sounds, especially since it is also applied as the investment grows and not just at the end.)

Okay. Maybe you’re a super saver. You probably are given that you’re thinking about this stuff as an MS4. You could potentially be withdrawing at the same or higher rate in retirement, especially with a lot of rental income. So is the answer in that situation to avoid the retirement account? No way. The solution is to make Roth contributions and conversions at every opportunity. Or is there something I don’t know about investments never being taxed again that is bad? I can’t think of anything. I mean, if you like the lower long term capital gains rate, you’re really going to love 0%.

But wait, there’s more. In most states, retirement account money is also protected from your creditors. While you’ll likely never need that asset protection, it’s nice to have it. Investments in your taxable account do not have similar protection. Sure, you can put a real estate property into an LLC, but that’s not quite the same thing.
Okay, I think we’ve addressed your/Mr. Wheelright’s first point.

**What About Leverage?**

It is generally true that it is easier to use leverage outside of a retirement account than in one. Brokerage firms don’t allow margin to be used in a retirement account like you can use it in a taxable account. But there are plenty of situations where leverage can be used in a retirement account. You can buy a leveraged hard money loan fund with a self-directed IRA, for instance. You can even put equity investment property in a self-directed 401(k) and use leverage on it. Yes, Wheelright is correct that it’s a significant hassle. But it can be done.

Now, I don’t necessarily recommend you put investment property into a retirement account. But neither do I recommend you try to leverage up all of your investments. Leverage introduces additional risk, and it is a good general principle of investing that you avoid taking more risk than you need to take. Most doctors don’t need to take on much leverage risk in order to meet their reasonable investing goals.

I think we’ve now addressed your/Mr. Wheelright’s second point.

**Are 401(k)s Inflexible?**

There’s no doubt that 401(k)s are less flexible than investing in a non-qualified account. That much is true. There is a price to be paid for those awesome tax and asset protection benefits. However, they’re not nearly as inflexible as the typical real estate investor thinks. Consider all the possible exceptions to the 10% penalty for withdrawing money before age 59 1/2:
- Unreimbursed medical expenses > 7.5% of your adjusted gross income (which may not be that high if you’re retired)
- Pay for medical insurance
- Disability
- Inherited IRAs
- Qualified Higher Education Expenses – for you, your kids, or your grandkids
  - A First Home for you, your child, or your grandchild.
- IRS Levy
- Reservist Distribution
- Early Retirement Via the SEPP rule

What exactly do you think you’ll need to tap your retirement money for that isn’t on this list? Besides, if you’re such a super saver that you’re worried you might pay more on withdrawal from a tax-deferred account than at contribution, you’re almost surely going to have investments that are outside retirement accounts anyway.

In addition, you can borrow up to 50% of a 401(k) or $50K, whichever is less.

I think we’ve now addressed your/Mr. Wheelright’s third point.
Bad 401(k)s

Another issue some worry about is lousy 401(k)s. Some 401(k)s have tons of fees and have lousy investments. Even in those cases, the 401(k) is probably still worth using. First, because you probably won’t be in it for long before your employer changes it (especially with all the lawsuits going on against employers for neglecting their fiduciary duty) or before you change employers. But second, the overall tax break is so large that it will overcome even moderately high fees over the long run.

A Reason To Avoid a 401(k)

Can I imagine a scenario where it might make sense to skip a 401(k) contribution in order to invest in something else? Sure. This would be a situation where I either had very limited investment dollars or exceptionally large retirement account availability AND a particularly attractive investment that could not be placed into the retirement account. I mean, if you can buy a surgical center likely to provide 30% returns going forward, then you can probably justify skipping the 401(k) that year if you absolutely have to. But I don’t think you should put all of your money into real estate, and if you’re going to invest in stocks and bonds (and even REITs), you might as well do it inside retirement accounts and enjoy the tax and asset protection benefits.
401(k) Vs Real Estate – I Invest in Both

As you can see, while there is some truth in what Mr. Wheelwright is saying, it can be very misleading. You owe it to yourself to understand how a 401(k) works and then make an informed decision about it. I suspect that, like me, you’ll choose to max out the 401(k) and then invest in real estate above and beyond the 401(k). You’ll notice I haven’t even talked about an employer match. I’ve never actually had one, but I’ve been maxing out a 401(k) (or two, or three) every year since I left residency. A match makes this all even better. A match is best thought of as part of your salary that you’re leaving on the table when you don’t contribute enough to the 401(k) to get it. That would be really stupid. I invest in real estate. I also have four 401(k)s. They don’t seem to be slowing down my wealth creation one bit.

What do you think? Would you skip a 401(k) in order to invest in real estate? Do you invest in both? Why or why not? Comment below!
Why Investing is Hard

Investing is hard. In fact, it is so hard that the combination of a decent income, financial literacy, and financial discipline is so rare that it effectively functions as a superpower. Today we’re going to talk about twelve reasons why investing is so difficult.

### # 1 You Need to Have Something to Invest

Inexperienced investors focus on the investment, while those in the know focus on having something to invest. Having something to invest requires three things:

1. A reasonable income
2. The discipline to not spend your entire income
3. Avoiding loss of earnings/capital through divorce, death, disability, liability, and speculative investments

You’re going to need a fair amount of each of those things to be successful, although you can often make up for a low amount of one of them with an extreme amount of another.
# 2 Wall Street is Out To Get Us

By Wall Street, I refer to the **financial services industry**. This can include bankers, insurance agents, stock brokers, attorneys, accountants, investment managers, financial planners, and advisors of all types. At the end of the day, these professions exist to transfer money out of your investments and into their investments. That’s not to say there are never times when they add more value than they cost. But in investing, you get what you don’t pay for. The **less you pay in fees**, the more you have and can use to save, invest, and later spend. The **successful investor is very fee-conscious**. She knows what fees she is paying and evaluates them periodically against the value received. She understands the financial conflicts of interest of her advisors and weighs the advice with them in mind. She completely avoids the vast majority of financial services firms and professionals like Odysseus tied to the mast.

# 3 Investing Takes Too Long

Successful investing is all about the “get rich slow” plan. That would be fine if we weren’t both impatient and mortal. Most reasonable investing plans span decades. Juxtapose that with our attention span, that may be minutes at best, and you have a recipe for failure. [Jack Bogle](https://www.investing.com/quotesstocks/usa/bogle-fidelity-investment-compan) has repeatedly said that the three most important words in investing are “Stay the Course.” It actually doesn’t matter what your investing plan is, as long as it is something reasonable. What really matters is that you can stick with it in the long run. Better to be 60% stocks and stick with it than 80% stocks and bail out in a **bear market**.

# 4 We’re Competitive

I like competition. I thrive off of it. As a kid, a friend and
I would play trampoline basketball. The game would last hours because neither of us wanted it to end. We didn’t really care if we won or lost, but we wanted it to be close. “Win by two.” “If I make this shot, I’m back in.” “Make it, take it.” “Dunks are worth two.” Nobody ever asked, “Why’s James crying?” because James didn’t cry. It should be no surprise that despite relatively humble beginnings, one of us founded The White Coat Investor and the other one is a successful Chief Investment Officer of a private equity firm. Now, most people probably aren’t as competitive as we are, but most people ARE competitive, particularly those who earn enough to actually be successful investors. However, when it comes to actually winning at investing, competitiveness is bad because it leads to two problems:

1. Keeping up with the Joneses. If you try to keep up, you spend too much and have nothing to invest (see #1 above).
2. We focus on beating the market or other investors rather than our own financial goals.

You see, investing is a single player game; it’s just you against your financial goals. You don’t have to beat the market. You don’t have to beat your neighbor. You don’t even have to beat your brother-in-law. The truth is we can ALL win. But if you don’t keep that in mind, you’ll end up succumbing
to FOMO- Fear Of Missing Out and end up buying high and selling low, a financial disaster.

# 5 It Requires Hobby-Level Dedication

Investing is a great hobby, perhaps the best-paying hobby there is given the cost of high-quality financial advice and management. But our financial world is so complex that if you don’t take up investing as at least a minor hobby, you probably won’t become good enough at it to be successful. That’s unfortunate since it is such an integral part of a successful life. Plus it’s boring for most of us. Here we are, with a second job as our own pension fund manager in our 401(k) world, and we know nothing about doing that job and have little interest in learning. What a tragedy.

On the other side of the problem are people who take it to the extreme. All of a sudden, all of our decisions are first weighed from a financial point of view, even when that is inappropriate. Perhaps we become miserly. Perhaps we become consumed by a quest for more, more, more. Perhaps we just can’t step back and end up living an unbalanced and unhappy (even if financially successful) life. Picture the 65-year-old retiree who spends 3 hours a day reading up on stocks. What a waste.

# 6 Wealth is What You Don’t See

This confuses all kinds of people. Lots of people think they want to be a millionaire, but what they really want is to spend a million dollars. Unfortunately, those two things are complete polar opposites. You literally become a millionaire by NOT spending the $1 million that you could have spent. This is surprisingly non-intuitive and I’m convinced not understanding it keeps many from being successful. So figure
out what you want – to have lots of money or to spend lots of money, and take the steps required to get there.

You literally become a millionaire by NOT spending the $1 million that you could have spent.

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# 7 The Frank-Starling Curve of Investing

The Frank-Starling Curve is well-known to physicians who care for congestive heart failure patients. The goal is to have the patient’s blood volume high enough to maximize the heart’s stroke volume but no higher. Too low, you give them fluids. Too high, you give them diuretics to take off fluid.

Investing is somewhat similar. Increasing the time and effort you put into it helps, but only up to a certain point. Beyond that point, you’re often hurting yourself. Someone who is invested in crummy mutual funds and never rebalances is on the left-hand side of the curve and would benefit from more effort. A day-trader is way off the right side of the curve. It isn’t intuitive, but at a certain point, more effort and time spent on the task is more likely to hurt than to help.
# 8 Debt Numbness

Spending borrowed money for educational expenses and basic necessities for four years in medical school (perhaps eight or more if the doc also borrowed for undergraduate) and then allowing that debt to become even larger due to deferment, forbearance, low Income Driven Repayment payments, or special resident refinancing programs for three to seven more years of training causes doctors to be numb to debt. Everybody they interact with owes hundreds of thousands in student loans. It feels normal. Due to the long period of indebtedness, this attitude toward debt extends to auto loans, credit cards, 0% down doctor mortgages, and even borrowing for the education of your own children! This debt anesthesia can severely retard your ability to build wealth. Instead of your income being used to live the good life and build wealth, it is used to service payments. You’ve become a fantastic investment for somebody else!

Investing is hard, but it’s no harder than finding passable highways in Baja California

A related problem is the concept of “good debt.” I read about
this all the time in blogs and books, although the definition varies. Mortgages get thrown into the “good debt” category because they may be tax-deductible and the underlying asset may appreciate. Student loans get thrown into that category because “they help you earn more.” Low interest rate debt gets thrown in there too, no matter what the original purpose of the debt was. There is no doubt that borrowing at 2% and earning at 8% is a winning formula. The problem is that the concept of “good debt” worsens debt anesthesia. You no longer feel like your debt is an emergency because it’s “good debt” so you justify not paying it off as quickly as you ought to. In addition, borrowing at 2% and NOT investing at 8% IS NOT a winning formula, but that’s what most who justify their debt because of its low interest rate do. Any time you have debt and you’re spending money on anything non-essential, you’re essentially borrowing to fund that purchase. You wouldn’t borrow at 4% for a Hawaiian vacation? How is that different from going to Hawaii while you still have 4% student loans? And 8% student loans? Are you nuts?

It’s a simple fact — money that is going to pay the interest (and even the principal) on your past spending cannot be invested for your future spending.

This debt anesthesia can severely retard your ability to build wealth. Instead of your income being used to live the good life and build wealth, it is used to service payments. You’ve become a fantastic investment for somebody else!

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# 9 You Change

Another issue that makes investing difficult is that very little is static, especially in your life. Your spending, your consumptive desires, your health, the size of your family, your tolerance for risk, and your income all change over time.
How can you set a retirement goal if your spending keeps changing? How can you set a savings rate when your income keeps changing? How can you set an asset allocation when your risk tolerance keeps changing? This need to stay the course is constantly butting up against the fact that the course is constantly changing, and that makes financial planning and investing a tricky business of constant adjustments.

# 10 The Investor Matters More Than the Investment

Too many investors focus their efforts outward, constantly searching for the best investment. In reality, they should be focusing inward, making themselves the best investor possible. The truth is that your actual investments, your asset allocation, so long as it is reasonable, matters far less than whether or not you can stick with it through thick and thin.

Too many investors focus their efforts outward, constantly searching for the best investment. In reality, they should be focusing inward, making themselves the best investor possible.

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# 11 We Are Poor Judges of What Will Make Us Happy

“Mann Tracht, Un Gott Lacht” is Yiddish for “Man plans and God laughs.” It turns out we are incredibly poor judges of what will make us happy. We think buying things, or buying experiences, or traveling, or giving money away will make us happy, then are surprised when the happiness we were seeking turns out to not exist or to not last. The problem comes when we start making long-term financial plans and it turns out that isn’t what we want after all. At its extreme, this leads
to divorces and massive repeated home renovations, both of which can be devastating for wealth building. But even in its more minor forms, it can be costly.

# 12 We Don’t Do Boring Well

Good investing is boring investing, but looking for excitement with your investments is a good way to go broke. Our desire for novelty is a major impediment toward staying the course with a long-term sensible plan.

Those are the twelve reasons investing is hard. Conquer them and you will find a simple, but not easy, pathway to wealth.

What do you think? Is investing hard or easy? Why? Comment below!