How To Become Wealthy On A High Income

[Editor's Note: The following post originally published as one of my regular columns for Forbes and gives 5 ways to rapidly turn a high-income into wealth. If you haven't heard, we're having combination discount on our online courses. If you buy Fire Your Financial Advisor between now and April 12th (and don't take advantage of the 7-day, no-questions-asked money-back guarantee), you will also receive 13 hours of video from WCICON18– including Mike Piper, Jonathan Clements, and Bill Bernstein. You get BOTH courses for the price of one. Don't delay, buy today!]

Income is Not Wealth

To the average American, the title of this post sounds silly. She may wonder, "Isn't someone with a high income already wealthy?" This person has not yet learned a critical distinction and an important lesson in building wealth–income is not wealth. The most common measure of wealth is net worth–everything you own minus everything you owe. It is entirely possible to have a very high income and have a negative net worth. Likewise, it is entirely possible to have a very low income and yet possess vast sums of wealth. Income is not wealth despite how our tax code, innumerable newspaper articles, and the majority of people talk about it.

Even someone financially astute enough to recognize the difference between income and wealth may express surprise that an article like this one needs to be written; "Surely it must be easier to build wealth on a high income than on a low one, no?" The answer to that, of course, is yes, all else being equal. The problem is that all else is never equal.

As discussed in my very first column here at Forbes, high-income professionals typically face a number of barriers to building wealth. These include a late start (their 20s and even part of their 30s are often spent in education and training), a high student loan burden, a progressive tax structure, high liability, high stress/burnout levels, and a general lack of financial literacy/business training.

While most high-income professionals should become wealthy eventually, the above factors prevent a surprising percentage of them from ever building significant wealth. (Remaining factors such as divorce and lack of financial discipline are common in all income brackets.) Net worth surveys of physicians in their 60s, generally at the end of a 30+ year career, show that one-quarter of them have a net worth of less than $1 Million, and 12% have a net worth of less than $500,000!

The good news is that this is a relatively simple problem to fix. Applying a few rules of thumb to a simple spending plan can ensure that anyone with a stable, high income can build wealth rapidly.

5 Rules to Becoming Wealthy On a

High Income

1 Save 20% Of Gross Income For Retirement

The first rule is perhaps the most important. The secret to building wealth as a high-income professional is to use your most important wealth-building tool, your income, to build wealth. This is done by not spending it and instead directing it toward wealth building activities like investing for retirement. Why is the recommended percentage 20% instead of the more commonly heard 15%? It's the high-income professional factor. Your late start and smaller relative benefit from Social Security tax payments require more savings.
It really doesn't matter what you do with the other 80%. You can spend it on a fancy house, a fancy car, fancy clothes, expensive vacations, private school for the kids, charitable contributions or heli-skiing. But that 20% is sacred. It must be dedicated toward saving for retirement.

Combining the 20% rule with a high income, a reasonable investing plan, and a typical career will result in retiring as a multi-millionaire. It really is that simple. Remember that 20% is from your gross income, so if you take the taxes out first it is really going to be 25-30%.

Also remember that any savings for other financial goals such as college, a house down payment, or a new car is going to be above and beyond that. Extra payments toward debt are also above and beyond the 20% for retirement. While it would be nice to be able to spend that 20% on whatever you like, the good news is that even 80% of a high income provides a very nice lifestyle compared to the [average American](#).

2 Pay Off Student Loans Within 5 Years of Completing Training

Lenders will permit you to put your student loans on a 20 or even a 30-year payment plan. This is generally a terrible idea for someone who actually wants to build wealth. The main reason is the income that is going toward servicing loans cannot be used to build wealth.

Want to become wealthy? Drive your cars a long time. This one is over 100 years old.

Perhaps more importantly, the financial discipline developed while [paying off the student loans quickly](#) can be redeployed toward building wealth. Most borrowers who pay off loans quickly also describe an emotional or psychologic relief at doing so, like a great weight has been lifted from their shoulders.

Paying off a sizable student loan burden within 5 years while also saving 20% for retirement will require a period of relatively frugal living after training, typically lasting 2-5 years. Completing this "Live Like A Resident" period will require delaying gratification and fighting off a sense of entitlement.

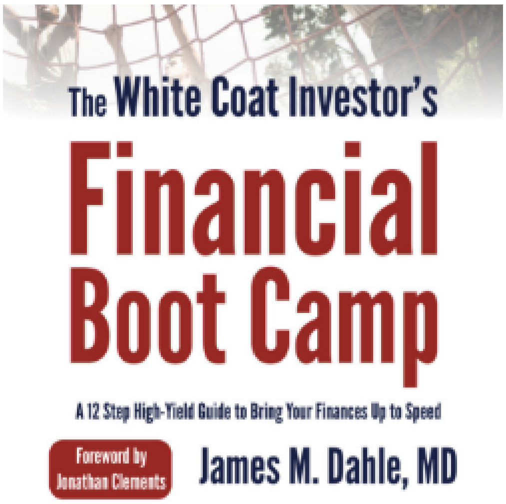
It also helps if you can limit the amount of student loan debt in the first place. A ratio of loans to income of 1:1 is reasonable and represents a good investment in your future earnings ability. The higher that ratio gets, the longer and more drastic the frugal living period will need to be.

3 Don't Become House Poor

Americans generally overestimate the amount of happiness they will get from owning a large, expensive house. Combining this with widely available "affordability calculators" available on the internet gets many doctors and others into financial trouble.

It helps if you realize that the ratios commonly used by lenders are for their benefit, not yours. They represent the maximum percentage of your income at which you are likely to be able to make the payments, not the optimal ratio for you to build wealth. A lender may be comfortable with payments that are as much as 43% of your gross income, but you shouldn't be. Since 20% of your income is going toward retirement savings and perhaps as much as 30% is going toward taxes, a house costing 43% of your incomes leaves only 7% for everything else.

A much better rule of thumb is that your housing (rent, mortgage, property taxes, insurance, and utilities) should cost no more than 20% of your gross income. An easier one to use that provides similar outcomes is to keep your mortgage to less than twice your gross income.



This ratio works very well for most high-income professionals in most areas of the country. In some very high cost of living areas, one will sometimes need to stretch that out a bit, perhaps to 3-4X your gross income. But realize there are very serious consequences to doing so, including working longer and spending less in other areas of your life.

4 If You Can't Pay Cash, You Can't Afford It

The easiest way to know if you can afford to buy something, at least outside of paying for medical school or your primary house, is to see if you can pay cash for it. Borrowing money to pay for cars, boats, vacations, appliances, furniture, or anything else is a good way to ensure that your income services payments instead of building wealth.

This concept seems amazingly simple, but there is almost always a less expensive version of whatever it is you want to buy. If you don't have the money for the more expensive version, don't buy it. This key principle of frugality is perhaps best exemplified by the classic saying from the Depression era—"Use it up, wear it out, make it do, or do without."

It doesn’t matter where your friends, family and neighbors vacation, what they drive, or where they send their kids to school. What you can afford and what they can afford are two very different things and resisting the urge to “keep up with the Joneses” is critical to building wealth. Wealth is actually the cumulative sum of all the things you didn’t buy but could have.

5 Choose A College You Can Afford

The same principle of frugality applies to college selection. There is a dramatic difference in cost from one college to the next, even when the quality of education is very similar. If a family cannot afford a given college between their savings, their cash flow, scholarships, and the student’s work during summers and the school year, they cannot afford that institution and should select one that costs less.

There is little reason to borrow for undergraduate education. This recommendation breaks down when discussing professional schools like medicine, dentistry, and law, but presumably, these degrees will eventually generate sufficient income to justify some debt (see # 2 above.)

It should be relatively easy for a high-income professional to build wealth, but it isn’t automatic. These five rules of thumb will help any physician, dentist or attorney rapidly turn their high income into wealth.

What do you think? Why do you think those with a high income have such a hard time building wealth? Do you have additional rules of thumb you would include? Comment below!