Recent Arizona Dental Grad vs. $10,000 Per Month Debt

[Editor’s Note: I recently brought Doug Carlsen, DDS, a dentist who retired at 53 and a great skier, on as a regular paid columnist in the hopes of being able to relate a little bit better to the dentists among my readers, and hopefully attract more dentists to the website. As long-term readers know, 80% of what is covered on this blog applies to everyone, no matter what their income status and 95% of it applies to all high-income professionals like attorneys and dentists. There is only a little in personal finance and almost nothing in investing that is solely unique to physicians. I just happen to be a physician and so it is easy for me to write about those few things that are unique. This is Doug’s first column. Please let me know your thoughts about the article in the comments section or by email. Doug and I have no financial relationship outside of the payments I make to him for his writing.]

I received the following letter from a young dentist recently. He represents the typical new general dentist in many ways.

I am 32 years old with three children aged four, two and one-half, and 6 months. I graduated from dental school in 2013. My wife has a master’s degree, yet plans to raise the kids full-time until the youngest is in school.

Debt:

- $440,000 in dental schools loans with income-based payments delayed until next year. My wife has about $40,000 of master’s degree school debt.
- Home loan of $155,000 with payments of $700 per month.
$28,000 2013 minivan for the wife with a 60-month loan at $500 per month. My car is a paid-off 1997 Honda.

$13,000 credit card debt.

As a gift to my wife for Christmas, we remodeled our kitchen for $15,000. She obviously spends much time there, so we thought it appropriate. It was the only part of the house not remodeled and Ikea had the 20%-off sale. I hope to pay it off from extra cash within several months.

More Potential Debt:

I hopefully will be closing on a dental practice purchase before the end of the year. The price is $500,000 with cash flow projected at $200,000.

Income:

I am associating, bringing home about $140,000 before taxes each year. We can live on a minimum of $60,000 per year after taxes.

Retirement Savings:

I have a $2,000,000 whole-life policy, which I’ve been told I take loans from in the future. I like the insurance guy—a personal friend—and he has the same policy!

Other Insurance:

My wife has a term-life policy for $500,000 and our kids have whole-life for $50,000 apiece. The agent told me the children’s insurance is for future medical denials.

Douglas Carlsen, DDS

This was my response:
Congratulations are in order on two counts: You and your wife’s professional degrees and having three young children. Life will certainly be exciting for all of you!

You and your wife have $480,000 in student debt. This is a formidable problem for the young professional family. Let’s look at debt principles. Psychotherapist Phil Tyson writes of two factors pertaining to debt:

First is a psychological principle called future discounting.

With debt, we often take it on with little thought of the details of changes needed to accommodate it. We look to the future and discount the pain of making payments. Credit card companies, banks, and especially car dealers recognize this principle well.

For a dental student, tuition, fees, supplies, and books are non-negotiable. Most live in less-than-ideal circumstances during those four years. To work part-time during school is normally not an option. So the young dentist is stuck with a large debt load.

Dr. Tyson’s second principle is the relationship between consumption and personal identity. Advertising has brainwashed us all to consume brands that provide us an identity. As adults, we wish to become a part of something bigger, to promise us the narrative of youth, beauty, health, and sexiness. Our self-esteem becomes captive to products.

For the young dentist with a $400,000+ albatross following four tough years of sacrifice, the lure of autos, homes, nice clothes, and cool electronic devices to prove one’s worth is extremely powerful. Many a new doc buys the Beemer and upgrades his lifestyle to match the “doctor look” with little attention paid to future financial struggles. They say “I deserve it!”
If you’re having trouble viewing the video, try this YouTube Link.

Student Loan Principles

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

1. The student loan creates a more complex debt structure, as yours is rapidly becoming, making saving more difficult in the future.

2. The young doctor will buy into an insidious mental framework of debt being a natural part of life. It isn’t. If you tie your identity to debt, you’ll end up needing to work ten to fifteen more years than the dentist that doesn’t. Debt is never your friend. Many will tell you to use debt for leverage, tax advantage, and other ploys. Nonsense!

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

Servicing the Debt

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

Right now, you’re not keeping up as your credit card debt of
$13,000 reveals. To spend $15,000 on your kitchen is nuts! That money could have paid off the credit cards. And you know how beautiful and uncluttered a kitchen is with small kids!

You currently have a total of about $675,000 of total debt, paying about $4,500 per month or $55,000 per year. Brian Hufford, a dental financial analyst, says your total debt payments for personal and practice should never go above 25% of your net income. Right now it’s 30-35%. If you purchase a practice for $500,000, the total debt grows to $1,175,000 and your total monthly payments, assuming a ten-year practice loan, will grow to about $10,000 per month or $120,000 per year. That’s 60% of the $200,000 projected income you mentioned….far above Hufford’s recommendation of 25%.

Also, with $120,000 in debt payments, you’d have to have an income of at least $160,000 per year just to pay your debt. That doesn’t include groceries, gas and car servicing and repairs, home upkeep and utilities, insurance, clothes for you and your kids, cable, medical insurance, co-pays and deductibles, or going out to dinner.

A practice loan puts a ton of pressure on young dentists. To purchase a practice with your current debt load will place a big burden on your life for years to come. Any other debt, especially a mortgage and student loans, makes it all that much tougher. It is usually prudent for a doctor to pay off student loans before the practice purchase and to purchase the home several years after the practice purchase. You will have a good idea what you can afford in a home after the first few years in practice. Fortunately, your home is not expensive and can almost be viewed as rent. But, please stop the home improvements!

**Dealing with Whole Life**

Yes, the whole-life insurance purchase was a mistake. Whole life’s investment portion normally will provide growth at best.
at the rate of inflation. Yes, you’ll hear promises of much more from the agents. Agents normally receive much more sales than investment training. Of course you like your agent. He’s your friend—until you change agents! These people feed on your emotions.

As for covering your kids with life insurance for medical insurance denials, it’s total hogwash! While Obamacare only protects against medical denials for health insurance, not life insurance, the fact is that a relatively tiny $50,000 policy isn’t going to provide anywhere near enough life insurance when your child really needs life insurance—when spouse and kids are depending on income, especially after 3 decades of inflation! There is no reason at all for any life insurance on your kids, as life insurance’s main purpose is to replace lost income.

Your wife has $500,000 term life insurance. She doesn’t need it now, if in good health, yet $500,000 in term will be appropriate in the future when she works. Some, however, would argue that a policy like that is a good idea as the services she is providing as a stay-at-home mother does have an economic value you would have to pay for if the worst should happen. You should have $2,000,000 in term insurance.

What to do about the whole life? Due to the structure of whole life, you may be better off keeping the policy (read WCI’s How to Dump Your Whole Life Policy for details), but if you choose to replace it, be sure to purchase more term life insurance first. Check out Inexpensive Doesn’t Mean Low Quality With Term Life Insurance for information on companies providing term life insurance.

Bottom Line

What you’ve gotten yourselves into is a feeling that you deserve at least a few of the better things in life. This is very common. Dave Ramsey calls it doc-itis. $480K in student
loans creates a large barrier to purchasing anything luxurious for the first seven years or so after dental school. One who does purchase luxury pays dearly. The fatal mistake is buying a nice home, nice cars, and starting a practice as soon as you can. At least you didn’t buy a huge home!

We will follow up on our Arizona dentist in a future article. In the mean time, why do you think many dentists and physicians get *doc-itis*? What did you do to minimize the effects of your student, mortgage, and practice loans on your future financial situation? Comment below!