Planning Your Professional Future

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NC Dental Society
May 20, 2017

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Assets Required at Retirement to Maintain Standard of Living

Monthly After-Tax Living Expenses	Percentage of Doctors at Spending Level	Annual After-Tax Personal Living Expenses	Annual Pre-Tax Personal Living Expenses	Amount Required at Age 65 (3% inflation)	Amount Required at Age 70 (3% inflation)
$2,500	1%	$30,000	$40,000	$811,500	$722,500
$5,000	11%	$60,000	$80,000	$1,623,000	$1,445,000
$7,500	18%	$90,000	$120,000	$2,434,500	$2,167,500
$10,000	20%	$120,000	$160,000	$3,246,000	$2,890,000
$12,500	13%	$150,000	$200,000	$4,057,500	$3,612,500
$15,000	14%	$180,000	$240,000	$4,869,000	$4,335,000
$17,500	8%	$210,000	$280,000	$5,680,500	$5,057,500
$20,000	5%	$240,000	$320,000	$6,492,000	$5,780,000
$25,000	6%	$300,000	$400,000	$8,115,000	$7,225,000
$30,000	4%	$360,000	$480,000	$9,738,000	$8,670,000

Assumptions:

1. Doctor will pay average combined federal and state income tax at 25%.
2. Doctor retires at age shown and lives to age 100.
3. Pre-tax investment return of 6%.
4. Amounts shown are income producing assets required only. Value of doctor's personal residence, vacation home, practice assets, personal property, life insurance, and Social Security benefits are ignored.

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McGill Advisory Articles | Personal Finances: Debt Management | November 2015

The Secret To Managing Student Loan Debt – Focus On The Cash Flow! (Online-Only Article)

By: Andrew Tucker, JD, CFP®, MTWM*

When it comes to repaying student loans, most doctors don't know where to start. The sheer volume of debt can seem insurmountable. Moreover, beginning practice with a large liability can seem crippling. The trick to overcoming this hurdle is simple – plan for the repayment of your student loans like any other asset in the dental practice, and finance the asset over its useful life.

Financing an asset over its useful life is a key tenet of business management. The reason for doing this is simple: by splitting up the expense of an asset, we can put the asset into service to make money in the business without derailing cash flow. This allows us to balance our goal of saving appropriately and reduces the stress associated with the ballooning effects of hurried repayments. Doctors regularly do this with equipment, practice loans, and building loans. However, the first instinct with student loan debt is to repay it as quickly as possible when, for all practical purposes, a doctor's education is the longest living asset in the practice!

The secret to managing student loan debt is simple, but very few people instinctively discover it: **select your method of student loan repayment based on *cash flow*, rather than focusing on the overall account balance**. A successful student loan repayment plan does not focus on the balance owed to lenders; rather, it's all about the impact of the cash payments made toward debt each month.

When creating a repayment plan, focus on the top three priorities, in the following order: 1.) provide necessary debt-to-income ratios to secure a practice purchase loan; 2.) provide liquidity to allow for proper before-tax savings and; 3.) repay the debt in the shortest term possible without sacrificing the first two priorities.

In order to determine where to begin, the following is a rough guideline for those with student loan debt to understand the basics about creating a plan to manage student debt while balancing other professional and financial objectives.

For the following percentages, the formula is as follows:

$$\text{Monthly student loan debt-to-income ratio} = \frac{\text{Standard monthly payment for a 10-year repayment schedule}}{\text{Gross monthly income}}$$

Scenario 1: Planning to Purchase a Practice in the Near Term (2 years or less)

In this scenario, the goal is simple – find the lowest possible payment available and keep it through the practice purchase process. For some doctors, this may be income-based repayment. If associate income is too high, this may be in the form of a refinance over 20 years. Regardless, stretching student loan payment terms in the interim accomplishes two goals: improved debt-to-income ratios and increased savings capacity to secure the bank loan necessary to purchase the practice. Purchasing a practice will normally lead to higher future income, allowing doctors to pay off their student loans faster.

The primary goal is to improve debt-to-income ratios, which is one of the most significant factors you can control before approaching the bank for a loan. By minimizing required payments to other parties, a prospective purchaser demonstrates a lower risk profile, since the need for cash from the practice is not as great as another doctor who has a larger monthly payment. By limiting the monthly debt commitment in the interim, this may make the difference between securing a practice loan or not.

The second goal is reducing monthly commitments to debt service to create personal savings. While after-tax savings has not historically been my first priority for a young dentist, the changing environment of dental lending has required some amount of personal savings in order to secure a practice loan. By reducing monthly loan commitments and planning for this hurdle by saving, a prospective purchaser increases the likelihood of securing financing for a loan.

It is important to note that, while a reduced repayment plan is the goal during a practice acquisition, switching to another format after cash flows and income in the practice increase is an advisable move. This strategy is best utilized as a temporary situation to improve cash flow as much as possible in the short-term to accomplish the goal of practice ownership.

Scenario 2: Monthly Student Loan Debt-to-Income Ratio of 40% or Less

In this range, the likelihood of seeking loan forgiveness is highly unlikely due to income level – repayment will likely be made in full, albeit it may be on an extended timeline. Rather than planning for forgiveness, the best course of action is to evaluate the refinancing options available on the private market and implement the strategy that best fits cash flow needs.

For doctors on the higher end of this spectrum, a 20-year amortization of the loan is typically advisable. While the interest rate is higher than shorter-term private loans, it is still lower than the federal rates for a

10-year amortization, and greatly reduces cash flow pressures that may prevent tax-deductible savings or prevent the purchase of a home. For doctors on the lower end of this spectrum (20% or less), a more aggressive repayment period of 5 or 10 years to reduce interest may be a better fit; however, this is only an ideal option if the refinance does not sabotage other savings and professional goals.

One strategy that I recommend frequently is the "floor method." In this scenario, we refinance loans over an extended period of time, typically 20 years. While we have a minimum payment, we plan to have a much more aggressive repayment schedule for the loan. However, rather than committing to a required repayment schedule that is more aggressive, we trade a slightly higher interest rate for flexibility in the monthly payment. This is a great strategy for doctors who are new to owning a practice and want to create a financial plan, but need to remain flexible with cash flow.

Scenario 3: Monthly Student Loan Debt-to-Income Ratio of More than 40%

In this scenario, significant hardship exists around paying monthly debt service at the standard payment, and student loan debt levels may be high enough that loan forgiveness is a possibility. In this scenario, do not privately refinance student loans; doing so will eliminate the federal provisions allowing borrowers to seek forgiveness of the loan balance after an extended period of time. (When they would be forgiven depends upon when the loans were taken.)

The most important thing to consider under this scenario is that, if and when a doctor reaches the 40% threshold, other repayment options should be considered. This is due to the fact that, once a doctor reaches a monthly student loan debt-to-income ratio of less than 40%, the likelihood that the doctor will be responsible for the full balance of the loans, and thus lose the ability to seek loan forgiveness, reduces the incentive to keep federal loans. Rather, the interest savings of a refinanced loan over a time horizon that meets the doctor's needs is a better alternative than the increasing monthly payments and high interest rates of a federal loan.

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