Obstacles to Savings For Retirement

Thinking of Retiring from Your Laboratory? Here are Some Things to Consider.

By Douglas Carlsen, DDS

Whether you are young or old, have a substantial income with many employees and multiple labs, or have a simple lab with few employees and moderate income, similar obstacles exist to foil one's chances to retire in the style one wishes and at the time one wishes.

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REVOLVING CREDIT

If you don't do anything else, please eliminate credit card debt. Paying by card is such an easy, yet insidious trap. Not only does it inhibit your ability to save, it psychologically entraps you. Many lab owners carry well over $50,000 in revolving debt, often paying over $10,000 annually in interest.

Psychotherapist Phil Tyson lists two factors pertaining to the psychology of debt:

First is a psychological principle called future discounting. We often take on debt with little thought of the details of changes needed to accommodate it. We look to the future and discount the pain of making payments.

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 a lab owner, it's so easy to go online to Restoration Hardware, Saks, Golf Galaxy, Patagonia, Brooks Brothers, Patek Phileppe (don't even think of going there!), and quickly establish a false sense of high self-esteem. Unfortunately, such consumption also sabotages one's wealth.

Plan:

Put a 24-hour hold on any impulse purchase over $500 and get permission from your spouse. Second, pay the cards off! Start with the smallest total card and work your way up. Psychologically, this works easiest.

After completely paying off one card, an amazing transformation begins to bloom. It's called satisfaction.

Too Much House

One's personal residence is often the largest block to savings. Revolving credit is worse emotionally, yet a big home saps your savings the most. Typically, a lab owner will buy a "starter" home in his or her mid to late twenties, then purchase that "trophy" home about ten years later, and finally a nice retirement home near or at a resort in one's 60's.

The second home is the one that destroys the ability to save. Just as the lab owner has paid off the large lab loan, there is a time when there is an abundance of cash flow. Many couples opt to use that money for the GPS (need to navigate via smart phone) house. The wise technician stays put and subsequently can ramp up retirement savings.

How much home can you really afford? Charles Farrell, J.D., LL.M, provides ratios at a given age to gauge whether one is on course to retire.

Mortgage to Income Ratio, Retirement at 65

Age	Ratio
25	2.0
30	2.0
35	1.9
40	1.8
45	1.7
50	1.5
55	1.2
60	0.7
65	0

For example, a 50 year-old lab owner, who wishes to retire at age 65 and has an income of $150,000, should not have more than 1.5 times, or $275,000 left on his primary home mortgage. If he owes more, it will inhibit his chances to save enough to retire by age 65.

Note the maximum amount of mortgage debt should never be more than twice your net income.

Farrell also makes it clear that your primary residence value increases only at the rate of inflation over many years. No, you won't be able to fund your retirement via your personal residence.

Don't forget home ownership costs including maintenance, insurance, taxes, and upgrades. For modest homes, these costs average about 2.5-3% of the home value per year. Expensive homes often average 4%+ per year. A $300,000 home may have $9,000 per year in the above costs; a $1,000,000 home may have $40,000 in costs. That difference of $31,000 a year buys a lot of retirement and college!

Why the higher percentage for more expensive homes? Upgrades, pure and simple. Higher cost homes in higher cost neighborhoods upgrade kitchens, baths, and landscaping much more than modest abodes.

Plan:

Sell and downsize? That's normally an impossible task emotionally. A better tactic is to stage any upgrades. Have a yearly upgrade budget of 3% of your net family income, no matter what the size of your home. That's $4,500 for a lab owner earning $150,000. Of course, a kitchen remodel may eat up over ten year's upgrade budget; a bath, five years.

Private Schools

A corollary to "too much house" is private K-12 schools and colleges. Those living in "nice" homes often feel neighborhood and peer pressure to have their children educated in "appropriate" schools. Top prep schools now average $17,000 per year with the Eastern elite schools charging $40,000+. We all know that private colleges cost well over $50,000 per year.

Start with that $17,000 per year for 12 years of private K-12 schooling for two children starting one child at lab owner age 30, the second at age 33. Invest that amount instead in a 50/50 mix of stock and bond index funds with 4% real growth until age 65. A lab owner will have a total of $1.24M more in retirement funds or $49,600 per year in 2014 retirement dollars by not paying for private K-12 school.

And the above does not include college!

Plan:

I personally know of families that have sought out the best public school neighborhoods, often with homes at reasonable prices. Or they have children that attend magnet schools. Their children later graduated with honors from University of California, Stanford, Harvard, and University of Michigan.

Bottom Line for Housing and Education costs: You can save $50,000+ per year living in a smaller home and/or staging upgrades and have $50,000 more per year in retirement by having children attend public primary and secondary schools.

Overconfidence in Investing

One quality I find in almost all professionals: we know we are smarter than the herd. There has to be a way to beat the system.

Yet, according to Carl Richards…."The smartest investors are the ones who acknowledge that they're not smart enough to forecast events or pick the best stock or avoid every scam."

He's right. No one can predict the future and those who try almost always fail. Sure, some guess right some of the time. Richards goes on to state that the ability to build and protect wealth is inversely related to having current market knowledge and acting upon it!

Plan:

Richards goes on to state, "The next time you're about to make an investment decision because you're sure you're right, take the time to have what I call the Overconfidence Conversation…..find a friend, spouse, partner, or anyone you trust, and walk them through your answers to the following questions:

Question 1: If I make this change, and I am right, what impact will it have on my life?

Question 2: What impact will it have if I'm wrong?

Question 3: Have I been wrong before?

Investing conservatively, diversifying over the total stock and bond markets with a buy-and-hold strategy, has been shown by countless academic studies to be the best path to financial security.

[I] Phil Tyson, Ph.D., "Do You Understand the Psychology of Debt?", downloaded at www.mens-wellbeing.com/2010/02/do-you-understand-the-psychology-of-debt.html on April 28, 2011.

[II] Charles Farrell, J.D., LL.M., Your Money Ratios: 8 Simple Tools for Financial Security. New York, NY: Avery, 2010.

[III] bid, page 85.

Downloaded from http://www.greatschools.org/find-a-school/defining-your-ideal/59-private-vs-public-schools.gs on 1/11/2012.

[IV] Larry Swedroe, Investment Mistakes, McGraw Hill, NY, NY, 2012, p. 138.

[V] Carl Richards, The Behavior Gap, Penguin Books, London, England, 2012, p.85.

[VI] Ibid, p.18-19.

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