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The Benefit of a Dental Partnership for Retirement

Facts:

- Age 26.
- $3,500 in an IRA.
- Negative net worth of $60,000 consisting of student loans.
- In July of 1999, at the age of 26, the client was offered a 33 percent partnership interest.
- The practice was collecting $1,100,000 and valued at $900,000.
- Based on the existing level of the practice, the income for the buying doctor was going to be $180,000.
- The overall net income of the practice was 42 percent before doctor benefits.

Goal:

- Achieve a potential retirement income of $150,000 per year by age 55, but not necessarily retire.

Phase I: Financial Planning

The goal was to begin educating the client on the benefits of saving early and taking an approach to lowering total debt without completely eliminating the benefit of time in the accumulation of wealth which was obviously on his side at only 26. This begins with showing a client their cash flow and setting up a path to save money right away. This is where most doctors will miss the mark because they will not understand their cash flow and, without that information, people tend to jump to the conclusion that there is not enough to save. In the case of this client, we determined that we would set a goal of $20,000 to $24,000 in savings for the first two-to-three years through the practice pension plan, but adjust as his income began to increase.

It was important for him to understand that $24,000 in savings would not get him all the way to his goal, but to not be discouraged and review the situation each year to know and understand when the cash flow allowed him to increase his savings. It was also important to teach him the concepts that the principal he was saving was making up most of his growth in the initial years, and the protection of the principal was more important than the return initially. By the end of the third year of his financial planning he had accumulated $90,000 and saved $72,000.

Phase II: Increased Savings

By 2002, the client had become a 50 percent partner. We began discussing an increase in savings to begin maximizing the pension plan opportunities to the doctor. This allowed the doctor and his spouse to begin saving $52,000 through the practice 401k plan and keep their overall savings at a level close to 20 percent of their income. This was critical in trying to reach the goal of financial choice by age 55.

We also began discussing the importance of adding another bucket of savings outside of the 401k to their financial plan. Personal savings or after-tax savings begins to build wealth that also allows the money to be used for multiple purposes such as real estate investments or lowering personal debt. In 2003, with planning and understanding their breakeven, they were able to add an additional savings of $35,000 in a personal account. By 2003, they had increased their savings from $24,000 to $87,000. Although the goals did not show continued savings in the personal account at this level each year it was a major step for this client to accomplish prior to seeing their lifestyle expenses begin to increase as their children began to get older.

In 2005 a third doctor bought into the practice. Since the practice had grown, it was valued at a higher level and the new doctor paid a higher price to buy a percentage ownership. This client used the proceeds he received to dramatically increase his personal wealth by adding over $200,000 after taxes to his personal investments. This increased his personal investments to $290,000.

By the end of 2006 at the age of 34 and 7 years into his financial plan the client had accumulated $750,000 of investable retirement assets and increased his net worth from negative $60,000 to $1,150,000.

Phase III: Diversification

The next level of planning began as the client's income continued to grow. With a good base of money accumulated it was time to start looking into continued increased savings. The first came with the advent of the Roth 401k. We discussed this and taught him that utilizing the Roth feature of the 401k was like saving extra money into his 401k since the government would not tax the money when withdrawn. In 2007, the client began maximizing his 401k deferrals as Roth deferrals and continuing to contribute the maximum profit sharing of $29,000 at that time.

Since 2007, his savings has increased with increases in the Roth deferrals and profit sharing in order to maximize the 401k savings, and in 2012 both him and his spouse began funding traditional IRAs and converting them each year to Roth IRAs. This increased their savings to $47,000 each year in Roth accounts and $35,000 in profit sharing for a total of $82,000 in savings.

The result is that by the end of 2015 the client had amassed $1,500,000 in investable retirement assets with $355,000 in personal assets, $735,000 in tax deferred assets and $410,000 in Roth assets. This creates a flexible growing retirement portfolio that is balanced between three different types of accounts.

Phase IV: Planning for the Future

Based on current projections and estimated continued savings the client is on track to amass enough financial capital to spend nearly $150,000 per year after taxes by the time he is 55. This assumes a 5 percent return over inflation. Although his living expenses have increased since age 26, this level of wealth does not entirely make him financially free, it does, however, create the ability to potentially stop saving and let their accumulated investments grow for the future. Based on a decreased return of 4 percent over inflation from ages 55 to 65 the client will greatly enhance his spendable income above his $150,000 goal. Additionally, the assumptions after age 65 are based on 3 percent net return over inflation.

Based on CWA's experience these results are far greater than the average general dentist between ages 55 to 65 and highlight the importance of making the right career choice, as well as hiring the right advisor to educate and hold you accountable to your financial plan.

Commentary

When it comes to career decisions, there are many young doctors that tend to evaluate the purchase of a partnership interest without considering that opportunities for growth are usually higher for multiple-doctor practices. With multiple doctors focused on the growth of the practice it becomes easier to be involved with the community, which raises awareness about the practice and spurs more growth than a single doctor practice. Younger doctors are also in a better position to take advantage of increased retirement savings opportunities and benefit from the compounding of wealth.

It can be a daunting task for a young doctor to see past the current net worth of a practice and determine the best path and strategy without the proper guidance and education.

The attorney representing this doctor initially told him he thought the practice was overvalued and he should not purchase the percentage ownership. The doctor believed in the practice and moved forward anyway. Within two years the practice had grown to collections of $1,600,000, the doctors had become 50 percent partners and the buying doctor's income had increased to $260,000. In 2004, the growth of the practice required a third doctor. By the end of 2005, the practice was collecting $2,500,000 and ready for a sale of a percentage to a new doctor.

Today the practice has three partners and will collect over $3,100,000. The net income is 50 percent since the fixed costs of the practice average only 13 percent instead of the 20 percent level common in a typical solo practitioner office. The doctor that was told not to pursue the purchase by his attorney now produces $800,000 in restorative work and earns $550,000 from the partnership.

The moral of this growth and net income story is to make sure you understand your long-term goals before saying "no" to a purchase. A partnership will usually create the ability to earn a higher income by the sharing of costs.

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