How Much Is Enough?

◆ Issue #40 ◆ Douglas E. Reese

Peace Of Mind For The Journey

One week from today, Lisa and I will be landing in Paris to begin a wonderful two-week getaway, visiting the French cities and countryside and trekking the Alps of Switzerland. As this is my first true international adventure, I was amazed at the work, planning, and detail required to coordinate such a journey…and for just 2 weeks! Thankfully, I have the master planner at my side in my wife Lisa who is both the detail queen and my international guide. After much discussion, many lists, and several trips to the stores, I feel quite comfortable that we have all that we will need for our adventure. We have been planning this trip for a long time and have been saving, shopping, and studying up on our French and German languages as well as all of the places we will be experiencing. I'm comfortable that on our trek into this strange land (to me anyway) we will have the time of our lives, not always knowing exactly where we'll be headed or even where we'll be sleeping some nights, but very comfortable that we have mapped out a very good course to take. Beyond that, I'll be ready to take whatever comes our way.

How nice if we could all feel as excited for the adventure and as secure with the plan throughout our retirement years, as I feel at this moment for my trip across the ocean. The small difference is that my trip will last just two weeks, while a "retirement" lasts for the rest of our lives. Most of the people we work with want a degree of certainty about their future ability to quit work, or at least reduce their work schedule at their own leisure. Very few of those we work with have a genuine desire to "retire." In fact, most have voiced a preference not to retire, but simply to shift their lifestyle to a more desirable schedule as time passes. So what if getting your plans together for this simpler lifestyle (we won't call it retirement, but rather "financial freedom"), could be as simple as mapping out a two-week trip to Europe? It's not quite that simple, but let me suggest a nice beginning point for those who do not have that sense of security that their future is in good order financially. And, for those who have a good idea where they are, this is simply a refresher course in financial freedom.

Let's start with the basics. To reach a point of financial freedom, by my definition, means you must have the necessary financial resources to provide for your lifestyle without the need to work. It's not much harder than that. So what are your "financial resources" you will draw from to provide for your lifestyle? Secondly, just what is your "lifestyle" need? Let's look at each of these two components of financial freedom.

Beginning with "financial resources," my work tells me that most dentists have 5 primary sources of future income, which include 1) savings and investments, 2) a dental practice, 3) an office building, 4) a home, and 5) Social Security income. Assuming that you will someday sell your dental practice, sell or rent your building (if you own one), possibly sell your home and move to something smaller (thus freeing up equity), and possibly receive a check from Social Security down the road, let's look at what value you have today from these resources.

My first recommendation is that you make a list of all of your "Savings and Investments" by account and value, totaling up all values to see how much you now have in this area. This list may cover a wide definition of "savings and investments" from savings and checking account balances, to money market accounts, to stocks, bonds, mutual funds, real estate, gold, and other assets of value. Secondly, I recommend that you write down the following three numbers for your dental practice, your office building, and your home…List your "fair market value" for each. Then, list all "debts owed" against the property whether a mortgage on the home or building or your total practice debt owed. Finally, take the "fair market value" and subtract the "debts owed" and you have a rough figure of "equity" in that property or business.

Now you need to make a decision about how you plan to receive value from your assets in the future. First you must decide, "Do I want to only use the income from my investments, or am I willing to use the principal also?" Second, you must decide, "How will I receive value from my practice and building? Will I sell the practice outright or over time? Will I sell the building or rent it?" And finally you should ask, "Do I plan on using any of the value in my home to generate future income?" If not, then leave this value out of the equation for this discussion.

At this point, you can roughly calculate your "current financial resource value." Take your total savings and investment value and add to it your "equity" value of the home, practice, and building (as much as you plan to use them for future income). That is your total figure for today. Now decide, "How much can I earn on this nest egg, to provide for my future income needs?" Let's say you conservatively decide on 8%. Take your total figure, multiply it by 8%, and you'll see how much income your nest egg would generate today. Next, we'll assume that Uncle Sam will want his fair share, so ask yourself, "What will my tax rate be when I'm no longer working?" It will likely be less than during your full-time work years, so let's use the amount of 25% for this example. Take your income generated from the nest egg, remove 25% from the total, and you have your after-tax income to support your lifestyle.

Finally we come to the all-important part two of our financial freedom equation, "What is my lifestyle need?" To determine this, you must have an idea of what it takes to pay for your total financial commitments throughout the course of a year. Let me give you a guideline for making this a little easier. Figure your needs in these 5 categories: 1) Taxes (income tax, property tax), 2) Insurance (premiums paid for life, health, home, auto), 3) Debt payments (your obligations for mortgages, loans, credit card balances, lines, etc.), 4) Savings (which will likely end at the point of financial freedom), and 5) Spending (which is the all-encompassing category for all cost-of- living expenses that don't fit into one of the other 4 categories). Calculate your "lifestyle needs" and come up with a dollar amount for a one-year period.

The deciding moment has arrived (drum roll please). Take your after-tax income generated from your nest egg, divide it by your lifestyle need, and you have your answer. This will tell you what percent of your current lifestyle would be covered if you "cashed in your financial chips" today, stopped work, and lived off of your resources. How close are you to achieving financial freedom? This is an important question that merits a fair amount of work to determine your answer.

Next month, we'll take this process a step further by choosing a point in time when you want to have achieved financial freedom and projecting your nest egg value of today into the future. I'll also give you a simple formula for quickly estimating your practice value and future lifestyle needs. Until then, bon voyage!

P.S. Here's the answer to last month's question, "How much would you have had at age 50 if at age 13 you had put $100 into savings and added $10 each month with growth of 4% per year?" Answer: $10,503! The same scenario only starting at age 7 instead is $14,103! The lesson: Time is precious and valuable, especially when it comes to financial stewardship.