chapter 1

Personal Money Management

Rule No. 1: Never lose money.
Rule No. 2: Never forget Rule No. 1.
Warren Buffet

Objectives

At the completion of this chapter, the student will be able to:
1. Describe common issues of personal money management for professionals.
2. Describe how personal lifestyle decisions affect the financial planning process.
3. Describe how savings affect the financial planning process.
4. Describe how to establish a personal credit rating.
5. Describe how to manage personal credit cards.
6. Describe the typical financial planning phases in a professional's life.

Key Terms

consolidation loan
credit card
credit rating (FICO score)
debit card
discretionary income
emergency fund
financial plan
identity theft
personal record management system
safe deposit box

Goal

This chapter presents a description of the financial planning process. The relationship between practice development and personal needs will be stressed.

Business Basics for Dentists, First Edition. David O. Willis.

Many financial planning issues that young professional dentists face are the same as the general public. However, in other ways, the issues for dental professionals are unique. They often start with high debt loads but balance that with high income levels. Dentists are generally not employed by a company or organization that provides any benefits such as medical insurance or a retirement plan. They are often limited in how much income growth they can expect and must balance their income wants and needs with their desire for personal time. Because of these issues, new dentists must quickly become familiar with how to manage money.

Personal Money Management

Become a Good Money Manager

Dentists need to become good money managers, both in business life and private life. The first step is to learn all about money and how to use it. Becoming a good money manager does not just happen; it needs to be worked at, just like becoming a dentist. Dentists should study how to save, how to invest, and how to become a wise consumer. They should subscribe to *Kiplinger's* or *Money* magazine. These are the two leading personal financial magazines, and they give valuable tips for saving and making money.

Personal Records

Dentists accumulate many important personal financial records, therefore, a personal record management system, similar to the one developed for the office, should be created. Dentists should not let the paperwork pile up; they should work on records every month. They should get a safe deposit box at the bank or a fireproof safe at home for important papers. These important papers include wills, insurance policies, names of advisors, certificates of ownership, among others. Dentists should keep all tax records and related items for at least 7 years and keep insurance policies as long as they are in effect.

Getting Professional Help

As a professional, dentists have skills and knowledge that the public does not have. Dentists not only work with patients to take care of a patient's oral health but also direct and intervene as professional expertise dictates. The same is true for managing financial affairs. A dentist may have a basic level of understanding of financial management, but there are times when the guidance of a person with expert knowledge in a specific area is needed. Most dentists go first to their accountant for advice about both practice and personal finances. An accountant can be used to help with tax planning, setting up basic retirement plans, evaluating the numbers of the practice, and personal budgeting. Depending on the background and expertise of the accountant, additional help for investment planning, establishing estate plans, buying or selling or partnership opportunities, and a host of other advanced financial topics may be needed. In these areas, dentists often use a lawyer, financial planner, or management consultant. This later chapter was not included in the book. The crucial point is that dentists should become actively involved in their own personal financial management and planning but use the expertise of advisors when the situations demand it.

Personal Lifestyle Issues

Increasing Lifestyle and Income

New dentists are often like a kid in a candy store when they first start making money. They have been in school for 8 to 12 years, are often married, and have put off increasing personal spending and lifestyle while in school. Suddenly, with new-found wealth, they buy too much (often on credit) and struggle the next several years to pay increasing bills with the increasing take home pay. The tendency is for lifestyle expenses to increase along with income. Every dollar that a person makes, is spent on a bigger house, newer car, and new toys. Unfortunately, the solution is not a fun, warm process. Personal life expenses must be kept under control. It is easy to increase lifestyle to meet increasing income. Once accustomed to a certain lifestyle, it is difficult to cut back spending, for example, to start a retirement savings plan. A solution is to develop and use a family budget. If income increases, then take half the increase and use it to fund spending or investment plans. Use the other half to increase lifestyle. In this way, lifestyle increases (more slowly than without savings) and a saving or investment plan is painlessly funded. This approach does take discipline however.

Spend or Save

When money is earned, it can be spent or it can be saved. As previously mentioned, after years of training, most new dentists want to spend it immediately and enjoy it. Instead, they should get into the saving habit. Dentists should start each budget period by saving at least 20 percent of take-home pay, learning to live quite

Table 1.1 Saving (and Investing) a Dollar a Day

	5%	8%	11%	14%
1 year	$374	$380	$386	$392
5 years	$2,073	$2,244	$2,433	$2,643
10 years	$4,736	$5,592	$6,651	$7,966
20 years	$12,544	$18,036	$26,627	$40,259
30 years	$26,416	$45,728	$86,628	$171,179
40 years	$46,639	$107,351	$266,852	$701,946

adequately on the remaining 80 percent. As income increases, they should save as much of the increase as is spent. As Table 1.1 shows, saving even a dollar a day adds up to a sizeable sum over time.

Developing Personal Savings

Emergency Fund

One of the most important financial tasks is to establish an emergency fund. The emergency fund should consist of 3 to 6 months' take-home pay, depending on the amount and type of disability income insurance and other liquid assets that are available in cases of emergency. The money should be put into a low-risk liquid investment such as a money market mutual fund or checking account. (Although this is not exciting, it is safe.) It is a form of savings used for emergency needs and not as a speculative investment. Emergencies that this fund might cover include a car that dies, a short-term disability, or paying for medical treatment. It is not a vacation or Christmas savings plan. Other than emergency purchases, this fund allows one to increase deductibles on all insurance policies, which saves substantial money in premiums. Establishing the emergency fund is one of the most important *initial* financial planning jobs.

Saving versus Investing

Saving is holding onto money, stashing it away so that it can not be lost. Gain is not expected. Investing is buying an asset (possibly a stock or a share of a mutual fund) that will *possibly* increase in value over time. When one invests, gain is hoped for, but loss is also a possibility. Both saving and investing are valuable goals in the right situation. If building an emergency fund or holding on to money for a short-term purpose, then the safest bet is to make sure it is not lost. Money should be saved in a low-risk fund, such as a savings account or money market fund. If retirement is planned for in 30 years, then the long-term gains that are hoped for by investing in a mutual fund is the better route. The value of the mutual fund may go down tomorrow, but it will hopefully (with wise fund choice) increase over the longer term.

Pay Off Debt or Build Assets

Should extra money be used to pay off debt, or should it be saved? Paying off debt as quickly as possible has become fashionable. Being debt free should be a long-term financial goal. From a purely financial standpoint, dentists should look at the after-tax return of the investment and the after-tax cost of the loan and then choose the one that gives a better return. If the interest rate is higher for the investment, then they should invest rather than pay off the loan. If the after-tax interest rate of the loan is higher, then they should pay off the loan. (See the chapter on business finance for a discussion of this topic.) From a cash flow perspective, cash may be needed for immediate necessities for the family or at the office. It is better to have an asset (the cash reserve) with a corresponding liability (the loan) than to have no cash and less of a loan. In the former case, a dentist may not need to go to a banker for an additional loan. In the latter case, when an additional loan is asked for, the banker may balk, wondering why previously loaned money was not handled properly. Once an emergency fund is built and an asset base established, then it becomes easier to put additional money into paying off debt. Again, comparing the expected return of investing with the savings from debt pay down is important. A final factor is one's personal temperament. A dentist must be a disciplined-enough investor to actually invest the money and not "blow it" on a purchase. Then the dentist must get the rate of investment return anticipated. If the loan is paid off, th dentist should have a plan for the monthly payment that had previously gone to loan payment. Finally, the dentist must invest that amount regularly or it will be spent with nothing to show for it at the end of the pay-off period.

Get Adequate Insurance

The chapter on personal insurance details the types of insurance a dentist might need. As a rule, dentists should not buy extended service contracts, which are a type of insurance. When buying a television, refrigerator, automobile, or any other major purchase, the dealer will try to sell an extended service contract. These cover most repairs needed over the term of the contract. It is better to see if the item fails and then pay to repair or replace it. The dentist should never buy additional (credit or mortgage) insurance. These types of policies insure that if one dies or becomes disabled, the policy will pay off a mortgage or car loan. These are expensive life insurance or disability policies. (Dealers sell them because they get a cut of the premium.) The dentist should have adequate life and disability insurance for his or her needs, and then remember to refuse these additional insurances when buying a major item. The dentist should never buy insurance from someone who calls because insurance policies should be investigated before being bought. As a rule, insurance should be shopped around for because it is a commodity item.

Personal Banking

Banks

Many new graduates have never had the problem and luxury of managing significant amounts of personal money. Establishing both a personal checking account and a professional (office) account are paramount. All checking accounts are not the same. Banks require different minimum amounts in accounts, charge different service fees, pay different rates of interest, and may limit numbers of checks that can be written. The dentist should shop around to find a bank that meets all his or her needs. Initially, he or she should find a checking account with low fees and low minimum balances. As assets and savings grow, the dentist should look for accounts that pay more interest and charge lower fees. Many banks allow and encourage patrons to banks electronically via the Internet. Monthly payments can be established, and transferring funds electronically to many different vendors instead of writing a physical check can also be done. If in a private practice and money was borrowed from a bank, the bank may require the dentist to keep all accounts with the bank. In this case, the "private" banking services, which add a tremendous amount of convenience to banking, can also be used.

Banking Services

Banks provide many services besides checking accounts. Most now offer e-banking, which improves convenience, and most banking can be done online. The banks loan money for small business or personal purchases and develop mortgages for large purchases. They offer credit cards for spending and often have accounts for credit card payments from patients. Many banks have special small business divisions that offer payroll and other services to the small business owner. They have safe deposit boxes for critical personal and business records. They often have investment advisors and retirement plan specialists to help a person develop and nurture these accounts. One of the first professional relationships that a dentist should make is with a banker.

Managing Credit

Credit Rating

Establishing a credit rating is another important step in financial planning. The major credit bureaus keep credit ratings on all Americans, using their Social Security numbers. This lets potential lenders quickly assess borrowers. The lender can decide if a person is a good lending risk by looking at how much he or she has borrowed before, and if the loan was paid off in a timely manner. With no credit history (i.e., someone has never borrowed money), the banker will probably deny the application for a loan. The problem is that the creditor simply does not know whether someone is a good credit risk. A credit rating can be established by acquiring a credit card and paying it off according to terms. A credit rating should also be nurtured by paying off all debts and credit cards on time. A bad credit history will haunt a person for many years. It can lead to denial of a practice, home, or other loan, denial of insurance or employment, or even the right to cash a check or open a bank or credit card account.

The lending companies commonly report a credit rating using a Fair, Isaac and Company (FICO) score, which was named for the company that developed the scoring system. (Some agencies use other, similar systems.) Scores range from 300 to 900, with most people in the 600 to 700 range. All credit scores begin at zero and a credit history is built up; it is not started at the top and subtracted down by poor credit choices. So without borrowing money or having any credit (e.g., credit card), a person does not have a credit history and is considered a poor credit risk in the eyes of the rating systems.

The higher the score a person has, the better his or her credit worthiness. A higher credit score means that it will be easier to get loans (and other forms of credit, such as credit cards), and the loans that are acquired will be at lower interest rates. Depending on the type of loan, lenders use the credit score, along with the full credit report, differently. They place more (or less) emphasis on particular components of the score, depending on their product. If a person is borrowing $200,000 for a house, the lender would obviously look at the person's score and history differently then if it was a loan for a $10,000 limit credit card.

Five major factors go into the calculation of a FICO score. They are:

1. Past delinquencies. If a person has failed to make payments in the past, he or she is more likely to repeat the pattern.
2. How has the credit been used? If a person is close to the limit on a credit card (or worse, maxed out) he or she is a greater risk.

Table 1.2 Free Credit Reports

Company	URL
Annual Credit Report	www.annualcreditreport.com
My Fico	www.myfico.com
Experian Inc.	http://www.experian.com
Equifax Inc.	http://www.equifax.com
Trans Union Corp.	http://www.tuc.com

3. The age of the credit file. A person who has had credit for a long time has a track history and is, therefore a better risk.
4. How often credit is asked for. If a person has repeatedly asked for credit over a short time, something may be awry financially.
5. The mix of credit. With only one credit card, a person is riskier than someone else who has several forms of credit, such as a home mortgage and other loans.

A person should check his or her credit history and rating on a regular (annual) basis. Each person can get one free from each of the major national credit bureaus. If a dentist is planning to buy a house, borrow for a practice, or make another major purchase, then he or she should check his or her history about 3 months in advance. If errors are found, this gives the dentist enough time to get them changed. Table 1.2 gives the Web sites of the major credit houses: Experian, Equifax, and Trans Union. They and the other sites also have a wealth of information on managing credit and debt. Depending on the study cited, 1 to 50 percent of consumer credit reports contain errors. Some may be simple and inconsequential (such as a misspelling). Others may affect a credit rating for years to come. Fraudulent activity, such as identity theft, may even be discovered. Inaccuracies can be irksome to correct. The Fair Credit Reporting Act requires bureaus to respond promptly. However, the bureaus will not necessarily change a history just because a person says so. (If they did, everyone would call and demand a clean credit history!) A person is essentially guilty until proven innocent. Proof and involving the creditor who sent in the inaccurate report are generally needed to clear a record.

Managing Credit Cards

Credit cards get more people into financial trouble than any other cause. Credit cards make it easy to buy things. When an item is purchased with a credit card, the issuing bank pays the merchant, essentially floating the credit card holder a loan for the amount of the item. The credit card holder can then "borrow" up to the limit on the credit card. (With debit cards, only the money present in an account can be used.) The credit card hold then does not have to pay the bank for the item until the end of the month. That works well if the credit card balance is paid off at the end of each month. However, if it is not paid off, the bank charges the credit card holder interest, generally about 1 1/2 percent on the unpaid balance. That 1 1/2 percent per month, when compounded, equals nearly 20 percent per year. So paying off a credit card balance is a wise idea. The problem is that it is easy to let the balances grow to overwhelming levels, and banks are too eager to let a person amass large credit card balances. The value of a credit card is being able to borrow money for purchases (up to the card limit) and the convenience of this form of payment. The obvious down side comes if balances are not paid off regularly or if a person borrows more than he or she can afford to pay off.

There are several common-sense solutions to the credit card problem, other than using credit cards carefully and paying them off monthly. If a person has a credit card problem, use a debit card (instead of a credit card) because only the amount of money in the account can be spent. The bank will deny the merchant's authorization if there is not enough money in the account to cover the cost of a purchase. This way, a person can not overspend. Dentists should have one personal and one professional credit card. All professional purchases go on the professional card, and personal purchases on the personal card. This keeps him or her more aware of the total credit card balance and keeps the dentist from running up the total balance by having balances on several cards. (It is a good idea to have a "back-up" credit card that has no annual fee. If a primary card is lost, stolen, or for any other reason becomes inactive, the back-up card can be used.)

If using a credit card, the dentist should shop around for the best deal for the monetary circumstance. "Gold" cards have higher credit limits and more generous terms than regular cards. The catch is that a person needs to qualify by having a good credit history and income. "Platinum" cards have even higher limits and requirements. Both cards have more advantages if a person is careful and has more rope to hang a person financially if not careful. Many banks issue cards with the name of a sponsoring organization (such as an alumni association) on the card. A small amount of money goes to the sponsoring organization (instead of to the card holder as higher rebates). Dentists should avoid these cards; they are expensive. Most cards have an annual fee; this should be as low as possible. (Dentists should negotiate with a credit card issuer to eliminate the annual fee.) A low percentage interest charge is also ideal; however, there is usually a trade-off between the interest and the annual fee. Higher annual fees lead to lower interest rates. (The converse is true also.) If balances are paid off regularly, the lower annual fee is better. Interest rates should not affect this type of consumer. If balances are not paid off in full, the lower interest rates are better. The cardholder should check to see when the payment due date is on a credit balance. Some cards require payment within 10 days. Others give the credit card holder until the end of the month for payment. Finding a card that gives rebates, as either cash rebates or travel points (or miles), is also a good idea.

Family Budget

A budget is a statement of how money has been spent in the past and an estimate of future income and expenses. As such, budgets become a target for day-to-day financial living. Budgets are most frequently used when a family is having a financial problem. The family then helps set targets for spending and lets everyone know why spending is limited in one area or another. A budget can help coordinate savings and improve living standards by identifying areas of waste.

Although each budget is unique for the person, some general targets for expenditure categories can be developed. No more than 30 percent of take-home pay should be spent for housing costs, 20 percent for food (groceries and eating out), and 15 percent for other miscellaneous expenses (Table 1.3). Debt payments (including student loan payments) should total no more than 30 percent of take-home pay. The budget should also detail paying a minimum of 5 to 10 percent of take-home pay into savings (personal and retirement).

Managing Student Loans

Most new dental graduates carry a significant amount of student loan debt. This becomes a problem that affects every other area of personal financial planning. Unfortunately, there is no magic quick fix out of student debt. The rules on student loans change frequently, so no detailed advice is given here; however, the same rules apply to this as to other loans. Dentists should practice good debt management habits and be persistent to pay off the loan.

There are two general types (at present) of student loans, subsidized and unsubsidized. In subsidized loans, the government pays the interest while a person is in school, training, or certain other situations. In unsubsidized loans, the interest begins to accumulate when the loan is secured. The interest rate is lower on subsidized loans as well. Given a choice, dentists should take the subsidized loans first and defer payment until the interest begins.

Table 1.3 A Sample Budget

Category	Percentage
Housing	30%
Food	20%
Debt Payments	20–30%
Savings	5–10%
Miscellaneous or insurance	15%

Dentists should consolidate student loans, both subsidized and unsubsidized loans. Consolidation does not work like other loan consolidations because the resulting interest rate is between the two. Given a choice, the dentist should consider paying off the high-interest loan faster rather than consolidating.

A career plan may lead to a professional opportunity that includes a given amount of loan repayment per year as part of the benefit package. Depending on debt and income levels, a person may qualify for a reduced payment scenario. Finally, student loan interest is deductible, up to an annual amount of interest. This deduction is limited for high-income earners. After a profitable practice is established, additional working capital to pay off student loan debt may be borrowed. Check the interest rates and tax deductibility of the interest before taking the loan.

Personal bankruptcy does not relieve a person of his or her student loan obligation. The only way to get out of student debt is to die. However, some unsubsidized loans become part of an estate's debt, so that even in death a person is not freed of the obligation. Dental students should check with loan services to be sure that there is a death benefit or life insurance rider that pays the loan obligation. Dentists should check the price of this insurance because it may be less expensive to buy additional term life insurance in the marketplace, rather than insuring through a loan servicing company.

Family Planning: The Cost of a Family

For many people, becoming a parent is the greatest challenge in their adult lives. These changing responsibilities, obligations, and commitments last a lifetime–once a parent, always a parent. No other life event causes people to become as thoughtful, careful, and focused on the future as having the moral, physical, and financial responsibility of raising children.

Children involve both additional direct costs and the indirect costs of increasing family size. Box 1.1 details some of these costs. No matter what people say ("Children are cheap. They hardly eat a thing!"), the simple fact is that having a family is expensive. For the dentist, these costs often come at a time when the family budget is already thin because of the need to pay off student debt and initiate a dental practice. If one parent quits work to care for children, family income gets squeezed even tighter. Some estimates place the cost of raising a child to the age of 18 at nearly $400,000. This does not include the cost of college, professional, or

Box 1.1 Extra Cost of Children

Babysitter or day-care expense
Buying (and moving) into a larger home
Remodeling or adding to an existing home
Buying a larger or more reliable car
Expanding insurance coverage
Higher insurance premiums
Moving to neighborhoods with better schools
Sending children to private schools
Paying for children's extracurricular activities
Taking family vacations
Paying increased medical bills
Buying more or different food
Buying more clothes and furniture
Buying gifts for children

Table 1.4 Car Depreciation by Year

Year	Depreciation
1	28%
2	20%
3	16%
4	8%
5	6%
6	5%
7	4%
8	3%
9	2%
10	1%

graduate schooling. Having children is an expensive proposition indeed.

What should be done to financially prepare for children? The dentist should do the same type of financial planning as was done before children, have a budget and stick to it. The dentist should have a properly funded emergency fund, more so now than before. He or she should expand savings and save for purchases, educational needs, and children's activities. The family should look closely at the impacts of having one or two working parents. One income means less money to spend and invest, but it also means that one parent will be available to care for children. Day care is expensive! Family finances will be different (costs such as day-care and work expenses), and the family dynamic will be different. The dentist should balance the trade-off in finances with the nonmaterial issues of family life.

Buying a Car

One of the first purchases a new dental graduate often makes is an automobile. However, he or she should consider driving the current car for another year; repair bills are generally less than monthly payments on a new car. If a dentist must have a new car, several strategies to maximize the dollar value of this purchase can be used. The dentist should pay cash and not finance the cost of the car. He or she should use an emergency fund to buy a new car and then replenish the emergency fund. If the automobile purchase must be financed, the dentist should not use dealer financing (unless they are running a really low interest rate promotion) because better rates can be gotten through a credit bureau or bank. The dentist should not buy a new car but buy a recent year, used car; the savings are substantial. Table 1.4 shows the amount that the price of a new automobile depreciates each year. Buying a 2-year-old car for about half the price of a comparable new car is more financially responsible, and it is often still under manufacturer's warranty. The market is full of cars that private individuals, corporations, or leasing companies have leased. Many still have some of their initial warranty remaining; the dentist should look for one of these cars and save. The National Association of Automobile Dealers (NADA) puts out a booklet each month that gives average prices for all makes and models of used cars. The dentist should get one of these books at a local bookstore and check the prices of cars. By selling, rather than trading in an old car, he or she can get a better price. (Trading it in is more convenient but how much is that convenience worth.) The dealer may offer a high price for the trade in but not discount the price of a new car as much. A buyer should not give car keys to a salesperson. ("Give me your keys and I'll have Fred check the car out to see what we can give you on trade in.") The buyer is then a captive and can not leave; the salesperson is in control. Instead, the buyer should walk with the salesperson to view the old car but keep the keys.

Automobile Insurance

Dentists can save substantially by managing automobile insurance. (See the chapter on personal insurances.) They should always shop for automobile insurance. This is really a commodity product. Insurance from one company is the same as insurance from another. They should buy comparable policies based on price and increase deductibles as much as possible. A $500 deductible policy will pay for itself compared to a $100 policy in about 3 years. (This is an example of the value of an emergency fund.) The drive should drop comprehensive and collision insurance if the value of the car is less than $3,000. Comprehensive and collision pay to fix a person's own car. If a $3,000 car is wreck, the emergency fund should be used to buy a new one. (A liability policy should be kept. This covers the other person's losses if the wreck is not his or her fault.) The driver should drop emergency road service and rental from the policy. These can be paid for out of pocket or by joining the auto club (AAA). AAA offers free road service and free maps. Buyers should shop for special discounts. Most insurers lower premiums if for good students, an installed alarm system, or if the VIN number is etched on the glass. The buyer should check to see what special offers a company has before insuring an automobile with them. Further, the buyer should integrate an automobile policy with an umbrella liability policy to avoid duplicate insurance or any gaps in insurance.

How to Improve Spending Habits

Whatever the present financial situation, there are only two things that can be done to improve it: earn more or spend less. Assuming a person has maximized earning, several steps can be taken to improve spending habits. First, a budget must be developed. Spending patterns should be examined, looking for areas of wasteful spending or areas that can easily be cut. The plan for financial improvement should be written down; it is too easy to come up with a vague plan. Until and unless the plan is written down on paper, it does not mean anything. Credit cards should not be used. Many people get into serious financial trouble using credit cards. Checks or a debit card should be used instead. Shopping trips should be separated from spending trips. Impulse buying leads to bad financial decisions. Expensive purchase items should be compared on the Internet or a shopping-only (not purchasing) trip taken. No purchases should be made on an initial trip. When a decision has been made, then the buyer should go on a buying trip to purchase the item; a better buying decision will be made in this way. Smoking and other costly habits should be quit. Saving a dollar a day and adding all pocket change will quickly accumulate savings.

Preventing Debt Problems

With debt management, prevention is obviously the best cure. Table 1.5 estimates what payments will be for various loans. This is important to ensure that payments fit the budget.

Keep a Reasonable Debt-to-Income Ratio

It sounds simple, but dentists should not borrow too much money. They should keep an accurate eye on the budget. Most lenders set a limit of 35 percent of total pretax income for the total debt load. This includes home mortgage, automobile loans, credit card, and other types of personal debt payment. In fact, a dentist may not qualify for certain types of loans if the debt payment-to-income ratio is too high.

Before Borrowing, Have a Specific Plan to Repay Debt

Dentists should work debt payments into the personal budget. This ensures that they will have the cash flow necessary to pay off the loan. If payments do not fit into the budget, something must be given up, either a present expense item or the anticipated purchase.

Table 1.5 Estimating Loan Payments
Multiply the loan principal (in thousands of dollars) times the factor to determine the monthly payment amount.

Monthly Payments on Each $1,000 Borrowed								
Years	4%	6%	8%	10%	12%	14%	16%	18%
1	$85.15	$86.07	$86.99	$87.92	$88.85	$89.79	$90.73	$91.68
5	$18.47	$19.33	$20.28	$21.25	$22.24	$23.27	$24.32	$25.39
7	$13.67	$14.61	$15.59	$16.60	$17.65	$18.74	$19.86	$21.02
9	$11.04	$12.01	$13.02	$14.08	$15.18	$16.33	$17.53	$18.76
10	$10.12	$11.10	$12.13	$13.22	$14.35	$15.53	$16.75	$18.02
12	$8.76	$9.76	$10.82	$11.95	$13.13	$14.37	$15.66	$16.99
15	$7.40	$8.44	$9.56	$10.75	$12.00	$13.32	$14.69	$16.10
30	$4.77	$6.00	$7.34	$8.78	$10.29	$11.85	$13.45	$15.07

Example 1: A new car is purchased for $30,000. The entire amount is financed at 8% for 5 years. What is the monthly payment?
PMT = 20.28 × 30 = $608.40/month
Example 2: A dental practice is purchased for $200,000. The entire amount is financed at 10% for 7 years. What is the monthly payment?
PMT = 16.60 × 200 = $3,320/month

Avoid Impulse Buying: Plan and Save for Purchases

Many consumers get into debt problems from their credit cards. They look at a bill at the end of a couple of months and realize that they have charged so many impulse purchases that they have reached their credit limit and now must aggressively pay down this expensive debt.

Pay Full Balances on Credit Cards Each Month

Credit card debt is one of the most expensive types of debt incurred. Most cards have a "grace period" built into payment schedules. The balance should be paid off in full each payment period so that interest payments on credit card accounts are not accumulated. If they are paid off, the borrower is borrowing the bank's money free. That is a good deal. Paying 24 percent interest per year is a bad deal.

Getting Out of Debt

If prevention has not worked, and a person has too much debt, several steps to reduce the debt load should be taken.

Understand There Are No Quick Fixes

A person can get into debt quickly, but it takes time to pay off the debt. The first step is to begin *now*. The longer a person waits, the more the interest accumulates. The person should admit having a financial problem and begin working to solve the problem. If overwhelmed, he or she should seek professional financial help. A banker, accountant, or a certified financial planner can help a person solve financial problems.

Be Ready for Lifestyle Changes

Getting out of a large amount of debt will be painful. A significant amount of money will need to be paid to lenders for an extended time. Unless income increases significantly, a person can not maintain lifestyle and pay off debt. Lifestyle may need to be reduced. A written plan should be made because until it is written on paper, it is not real. The borrower should also take on no new debt. Credit card accounts should be closed and a written accounting of all income and expenses should be maintained. A personal financial analysis should be done and this information used to budget for spending. All extra income should be put toward paying off debt.

Work with Creditors

A person should not hide from creditors. Eventually, they will find him or her. Creditors want to be repaid. They will work with a person to develop a payment plan that can be met. However, creditors must be kept informed. They may help by offering slower repayment plans or other methods that help a person get out of debt, which helps the creditor get paid the money owed.

Consolidate Debt When Necessary

Debt consolidation is when a person has several high-interest loans. It may be so difficult to make these payments that the interest accumulates faster than it can be paid off. If a person can borrow money at 10 percent to pay off an 18 percent credit card, he or she is usually better off. (Origination fees and other requirements of the consolidation loan need to be researched.) In this way, the consumer can consolidate these expensive loans and, hopefully, pay off the debt more easily. Note that this technique is primarily for people who are in debt trouble. Consolidation is not the simple panacea that some lenders make it out to be. A person now has one lender who may not be sympathetic to problems.

Use Tax-Deductible Debt, If Possible

There are times that it is to a person's advantage to use home equity loans or business loans (working capital) to pay off debt. The interest rates (effective after-tax rates) should be compared to decide which is best.

Accelerate Debt Payments, If Possible

As a rule, the faster debt is paid off, the less interest payments are made. Therefore, on the face of it, it is always a good thing to pay off debt as quickly as possible. However, there are several times when this rule of thumb may not be valid. A person may need to stretch a debt payment out to have adequate cash flow for other budget expenses. Or a person may have an incredibly low interest rate or generous terms on loans that make them attractive to keep.

A small additional payment makes a huge difference in the total loan payout. Box 1.2 shows what happens to the number of payments when the amount paid each month is increased. By simply adding $50 per month to a 10-year loan, it halves the number of payments made. (The principal paid remains the same, but it is paid more quickly and paid with less interest.) Greater savings are

Box 1.2 Making Larger Loan Payments

Principal = $100,000
Interest Rate = 9%
Term = 10 years

Normal Payment	Additional Principal Payment			
$1267	+$50	+$100	+$200	+ $500
Payment	$1317	$1367	$1467	$1767
Years	5.0	4.9	4.6	3.9

Box 1.3 Financial Planning Phases

Phase 1
- Build the emergency fund
- Buy appropriate insurance
- Develop savings habit
- Establish family budget (spending patterns)

Phase 2
- Increase emergency fund with income
- Decrease insurance deductibles
- Begin retirement savings
- Begin children's college funds
- Begin investment portfolio
- Increase lifestyle (modestly)

Phase 3
- Maximize retirement savings
- Maximize personal savings and investment
- Increase lifestyle
- Buy toys

Phase 4
- Maximize lifestyle
- Donate wealth

seen with larger monthly additions. Most loans (especially mortgages) do not have any prepayment penalties associated with paying all or some principal off early. So if cash flow will support it, a person can come out ahead financially by making an extra principal payment as often as possible.

Financial Planning Phases

There is a typical order of financial tasks for young professionals to consider. These will be different for different life situations. The dentist who is single in a lucrative practice will have different constraints than a married dentist supporting a family in a start-up situation. A person will enter the phases of financial planning more or less quickly and have different emphases within the each phase than another person.

Phase 1: Increasing Debt

The first phase typically is marked by high debt levels because the graduate purchases a practice and often a home. The dentist should keep borrowing and spending under control. An initial task is that the dentist has adequate insurance. Part of personal insurance planning is to set the appropriate deductible for the circumstance. As the emergency fund is built, the dentist should decrease deductibles and decrease the cost of personal insurances. He or she should build the practice or professional situation, increasing earnings by making the practice profitable through increasing production and decreasing costs. The dentist should be sure that family spending patterns do not increase faster than income and saving increase. He or she should start funding an individual retirement account as soon as able. This helps to build a savings habit or mentality, as opposed to a spending mentality.

Phase 2: Increasing Income

During the second phase, the practice begins to generate higher income. As income increases, the dentist needs to decide what to do with the additional money. Part of the increase (half) should be used to increase savings and begin investments. As income increases, so does the amount needed for the emergency fund. The dentist should fully fund this increased emergency fund and check that insurance benefits and deductible amounts are appropriate. He or she should start a practice retirement plan and begin saving for children's higher education expenses and personal investment portfolio. The dentist should estimate personal income taxes appropriately. As income increases, loan payments remain steady, and depreciation deductions decrease (generally around year 5). At this point, many dentists find that they have not planned well for taxes and need to borrow cash to pay current taxes. Finally, once the savings habit has been developed, the rest of the increase should be used to improve lifestyle.

Phase 3: Maximum Cash Flow

During the third phase, the initial practice loan is paid off and practice income is high. When the practice loan is paid off, the dentist should reallocate half the monthly payment to increasing the retirement plan, use half the remaining half to increase personal savings and investment, and the rest to increasing lifestyle. Extra payments to retire debt to become debt free can now be made. At this point, the dentist can begin buying the toys (house on the lake, airplanes, etc.) desired.

Phase 4: Maximize Lifestyle

During the fourth phase, income is at its peak and expenses are at their lowest. A person has educated children, paid house mortgages, developed savings, and funded retirement plans. At this point, working becomes a choice, rather than a necessity. The practice and personal life can be what a person wants them to be, free of worrying about money. Many people find that they have more time to devote to social and religious causes and find additional activities to give their lives meaning.