Ep #18: Making Up for Lost Time

Full Episode Transcript

With Your Hosts

Dr. David Phelps and Evan Harris

You are listening to the *Dentist Freedom Blueprint* podcast, with David Phelps and Evan Harris. Navigating you through the uncharted waters of a turbulent economy with straight-forward advice to, transform your practice into a self-sufficient cash machine, compound your net worth assets, and multiply, multiply, multiply your passive cash flow streams.

Evan: Well, good day, this is Evan Harris with my friend Dr. David Phelps on the line. David, are you there?

David: Evan, glad to be back with you today. I'm excited to jump into another topic and lay out Freedom Blueprint for listening dentists today.

Evan: Excellent. Well, I just had a conversation with a doctor and good friend we were talking off the cuff, privately, and I asked the question, "Doc, how many more years do you want to do this?" And he looked at me, he says, "Do you want the real answer?" I said, "Yes, I do." He says, "Evan, four years ago." I said, "I'm sorry?" He said, "I wanted to be done four years ago." "Wow, okay. And when do you plan to be done?" He says, "The day I could be done I'll be out of here and I'm looking for about two more years."

And this guy is typically a pretty happy guy, but when asked that question I could feel his body language change and a sense of obligation rather than a freedom. After practicing 35 years I would say to have him look at me like he had to be there. And wanting to be gone. Not that he doesn't like dentistry, but he had so many more things he wants to do, but feeling constrained by the finances.

My question to you, David, today, is why does it seem is it just my world or is it more broad than this, why does it seem that we have very competent, hard-working dentists, feeling that squeeze today of not knowing how or when they can retire? Is this common or is this just something that I'm experiencing?

David: Unfortunately, Even, I think it's very common today. And you're right, the doctors that we have a chance to work with are I would say all across the board very competent, hard-working, they take a lot of CE courses to be the best that they can be in their practice. Really what's happened is the traditional financial-planning model, Wall Street model, has failed them. Over 97 percent of the calls that I get from dentists every week that are over the age of 55 start with, "Hey, David, I don't think I have enough to retire. I fear that I'll have to practice until I die."

What I come back with them is this. More time or working harder is not going to be their answer. I mean they're running out of time at this point. Time is not on their side. They've already proven that working hard and trying to save their way to financial freedom is just not a working model, even though every financial planner and advisor has told them otherwise.

Taxes are also a big problem today and taxes are going to get worse, Evan. Taxes are destroying the wealth creation of the middle class today and you can't really outrun them. Taxes will be the demise of many people despite their best efforts. The tax code today does not at all favor high-income earners. In fact, active labor, active labor that produces income say from small businesses and professional practice owners is the highest taxed form of income there is.

The tax code does, however, reward the accumulation of assets, particularly capital assets. But this is a model that's foreign to many because it was not taught to really any of us, myself included, by our parents or in college, and really today not by any of the professional advisors.

Evan: Okay, let me back up one quick second. I think I heard you say the tax code does reward accumulation of assets. What do you mean by accumulate and what assets are you speaking of?

David: Exactly. Well, we have to differentiate between our active labor. And again, that's where we were taught to go. That's why we went to school for so many years, right Evan, is because we wanted to become highly-skilled with patient dentistry, because we were told that would produce freedom. Doing dentistry, being in a professional practice can certainly produce a good income, but the tax code doesn't reward that. The tax code really goes after those who are hard workers, the entrepreneurs, the capitalists who trade their time and labor for dollars of income. That is our starting point, but we've got to learn to transition to accumulating what I refer to as capital assets.

What are capital assets? Capital assets are either real businesses, not like most professional practices, unfortunately, but real businesses where the business is not predominantly require the professional practice owner to be involved in the production of that income or my favorite, and one that you and I both love, Evan, is real estate. Most professional practice owners are not good business owners. They are good technicians, they're very skilled, but that only leads to higher income, trading time for dollars, and that limits wealth accumulation.

Evan: Okay, so in my mind I'm thinking we've got two sets of people listening to us right now: we've got those people who are young enough to be able to take down some notes, I'm going to crush it, I'm going to add more, real estate, I'm going to figure this thing out, and I've got time. I also have the other group in my head that's making angry faces going, I don't have that time. That's nice guys, that's really cute, but what about the people who are already behind the eight-ball, who are already behind retirement planning? They're trying to make up for lost time. This is the doctor that looked at me with fire eyes of wanting to be gone four years ago. What do you say to those who are already behind and they're trying to make up for lost time and make much bigger returns or much bigger tax-efficient wealth?

David: Okay, Evan, we're talking about capital assets and in this case I'm going to talk about real estate. I am not talking about financial assets, being the stock market bonds or annuities, just to be clear here. The fastest way to build up more capital assets is through leverage. Leverage period. You want any speed injected into your plan, you've got to leverage.

Evan: Break that down. What does leveraging look like within the asset though?

David: There is lots of ways that one can leverage. You could leverage other people's time, that would be people that you employ or you contract with that produce services or products that we can use. You can leverage other people's talents, their skills, experience. You could also leverage other people's money, and other people's money could also include a bank, financial institution. I will talk about that in a minute.

Those people who know me well know that my preference is to leverage with non-institutional, that is not bank money or I like to use private money, real people. Not banks where they're institutional lenders. To do this requires an experience in investment structures and also to have a network of financial friends. Now this takes time to build that kind of a network and a lot of people don't have time or they want to fast track, even if they're younger they want to fast track.

Evan: What about the people what they do who are watching the news out there right now and they're just wondering is now really a good time to leverage? I hear that leverage can be dangerous? What about this fragile economy? What would you say to them?

David: Well, to be fair leverage is a double-edged sword. There can be good leverage and bad leverage so I want to clarify and make sure that our listeners understand that I'm all about using leverage the right way. I do believe we're in a perfect storm. Here is what I mean by that. Right now I think we're in a false economy. The rebound from 2008, the credit in the housing financial crash that we had, we've seen that turn around. We have seen somewhat of a rebound in all aspects. The stock market's flying high today, real faith has come back, and the banks are actually lending money again.

Now I'm not going to go into the details as to why I think it's false right now, but it is what it is. We have to take what we see out there, Evan, we have to understand what it is. There are ways to hedge your bets even amongst something that we may not believe is really a strong foundation. The reason why we're seeing a lot of rebound in the markets today, housing and the financial markets, is because the federal reserve has digitally printed billions of dollars. That money finds its way back into both the stock market and real estate market.

I believe the stock market is ripe for another major downward correction. The real estate market has somewhat tapered off and we may see a modest deflationary trend when the stock market drops. I don't expect to see anything major in the cash flow market that is the real estate markets.

Today interest rates are at historic, all-time lows. They shouldn't be where they are, Evan, but they're where they are. That is why I say we've got to take advantage of the opportunity when it's there. I am going to predict that interest rates will probably stay pretty much where they are at least through 2015. What does this mean to you, our listeners?

Well, if you have access to good, solid cash-flow-producing real estate and Evan and I both love single-family houses, and you have good turnkey management. Again, I'm making a case for two key components, good cash-flowing single-family houses, and you've got to have good turnkey management, that now is a great time to leverage like never before by using bank or institutional funds, which they over-owe 5 percent. You can get 25-, 30-year fixed-rate terms and this is courtesy of Fannie May, the quasi federal agency that's being subsidized by your tax money.

Evan: I sense a little sarcasm there and I agree with that. Let's go and give ... I'm a visual guy, so let's do what we can and break that down. As we're talking many of our practicing professionals they've got solid credit, they're able to get bank or institutional funds at below five percent because they have a great track record. Most practicing professionals are in their business 20, 30, 40 years so they're a pretty safe bet. If I understand correctly because that money is so affordable they could be able to borrow up to five percent and be able to utilize that money to invest in a much higher rate. Could you give us an example of how that would work?

David: Sure. Let's start out with a non-leveraged example, meaning that we're going to buy a capital asset, let's take a single-family house that's been fully rehabbed. It is ready to be occupied by a tenant. This one house in the markets that I like to invest in, Evan, which Texas and the Midwest, Oklahoma and Ohio, for example, we could buy this house today all rehabbed for $100,000 cash. Let's take all of our cash, let's put it into that property, that's a very doable product to get in the markets around this country.

Now this particular house today in those markets will produce about $10,000, a little over $10,000 what I call triple net. Triple net means that's after paying all of the expenses of managing that property includes the management, the people who manage it because I don't want the doctors managing the property. You have good management in place to manage the property. That covers tenant turnover, we will have some turnover. The better property you buy the less turnover. There is going to be taxes, insurance, and there's always going to be some maintenance. On a fully rehabbed property that's the key, you'll have very few surprises or what we call capital expenses that come down the line.

This property, after all those expenses will produce $10,500 give or take on a triple net. Now if we put $100,000 into that property that's a little over a ten percent cash-on-cash return. Does that sound pretty good Evan?

Evan: Comparable to what's out there nowadays if I look at, well, what's the CD rate right now? What would you say that is?

David: CD rate I think if you push it you might get close to one percent.

Evan: Yeah, yeah, on a really, really good day you'd be quite a savvy negotiator to get that one percent, but yes. Ten percent absolutely today that … secured by national house or home in my opinion is a solid insurance.

David: So far so good. We took $100,000 of money that, like you said Evan, could have been in T-bills or in CDs earning one percent or less and we've deployed that and put it into a non-leveraged all paid for cash, $100,000 property that's now producing ten percent net after all expenses and management. We both agree that's pretty darn good. In a sense my point with this episode is to talk about how we can fast track building more capital assets because if we have to wait until we work hard, pay taxes, pay overhead, pay all that stuff, and then take what's left over and accumulate another $100,000 that might take a little bit of time, Evan. Again, the point here is time is not on our side. How do we speed this up?

What if we take our $100,000 cash that we have, instead of buying one property all cash, we put 20 percent down. That is $20,000 and we buy not just one house, but we buy five houses because we can finance the other 80 percent at today about 4.75 percent fixed rate 30-year percent financing. Now five such houses, even after paying all those expenses and this time we have some debt service, each house will still produce about $5700 net annual income. That is after all expenses, management, and now the debt service. Now that $5700 annual income ...

Evan: So that's …

David: Yeah, that's it. Now we've got five houses. If we multiply the $5700 net income times five we've got a total annual net income of $28,500. By using leverage we've increased our net cash flow from the $10,500 from the one non-leveraged house to $28,500 per year, that's almost a factor of three. But Evan ...

Evan: I'm imaging to my listeners here that's got to be a pretty high opening type of a business.

David: Well, think about it, we've got $28,500 net, net, net, and that was with our $100,000 cash. What kind of a return is that? I used easy numbers so we can figure it out pretty easily that's now 28.5 percent cash-on-cash return in good solid real estate. Versus a ten percent cash-on-cash return we had with a non-leveraged house. We have basically tripled our return and we've got five houses. Think about what five houses will do, Evan, over the years particularly if one anticipates that at some point we're going to start to see a much higher degree of inflation. What is that going to do?

Well, five houses are going to keep up with inflation just like one house. Now we've got five houses tracking and we also with inflation the cash flow, the net cash flow, the rental income of these properties is also going to go up. We have hedged our bets against inflation. Even if we don't have inflation, Evan, even if we don't have any inflation over time the tenants are paying down the debt. That 4.75 percent debt that we're paying down over the years and eventually, eventually will pay down enough debt that we could take half of the houses that we've leveraged, sell them and go back and pay off the other half, and now we can have a free and clear portfolio. To me that's the end goal. You can only get there faster if you consider using the right kind of leverage.

Evan: So David, if I understand correctly we take the leverage of a good credit, practicing professional, the ability to be able to find a solid investment. Being able to leverage it with multiple property leverage loans on those properties that are a good, safe bet, and being able to turn that $100,000 cash into a $28,500 annualized return. Why don't more financial planners give this kind of advice?

David: Well, for the simple reason, Evan, that number one, they don't make a living selling capital assets, they sell Wall Street products, the stocks, the bonds, the annuities. That is what they've been trained to do, that's when they sell those products they're easy for them to sell and they get commissions or fees from those. That is their world.

Simply they just don't understand about capital assets, they don't understand about real estate. It is not within what I call their wheel house. Today I'm not telling our doctors now to utilize financial planners. They are not bad people. They are educated in a certain arena, certain area. When you need insurance products, yes, go to someone who understands those products. You will buy the appropriate product there, but here's the question I ask, Evan.

Let me just put it this way. If I went to someone to get financial advice I would look for somebody who gives on the same track that I want to be on. That is instead of trading time for dollars selling products and services. I want to know what are they doing also to build up their freedom plan? If they're not involving any capital assets then I'm not going to look for advice from that person for the big picture.

As I said earlier I'm not a big fan of institutional bank financing, but if I was behind on my retirement capital this schedule I wouldn't hesitate to leverage good real estate today while this window of opportunity, which we don't know how long is going to last, but while it's still open this is the way to fast track right now. This is what our economy, it's what our government is giving us. Whether we like it or not, but this is the way to use it. It is the power of leverage.

Evan: I like it. I had a doctor recently come to me, he said that he had recently got his model redone. I said, "Wow, what brought that on?" He said, "You know, funny thing, there was a patient that he was giving a treatment plan to that was a smile-design case, and the patient declined and decided to go somewhere else. The doctor asked why did they decide that they didn't want to do the treatment? The patient very bluntly said, 'Doctor, I'm looking at your teeth and I'm thinking do I want the artist transforming my smile to have a smile like yours'?"

And doctor, he said, "Evan, you know, it set me back. I have had these teeth my whole life, my whole adult life." For him who was always focusing on inclusion and dentition and being functional, but never did they ever think about aesthetics. Here this doctor was prescribing an improvement of aesthetics to a patient that wanted aesthetics. The patient looked at that doctor and said, "Well, why would I go to you when aesthetics obviously are not important?"

I loved your comment about the financial planner. Having our listeners ask the people who are doing what they want to do and they're living a life that they want to live. When people ask me about security, I grew up. My dad was a professional money manager is whole life, I went on the appointments with him, that's why I feel like I have an unfair advantage because I understand that world because that's what I grew up in. My wife's whole family is all real estate so I grew up 20 plus years with them and understanding real estate. I personally have chosen that vehicle for myself because I feel like it brings the very best gain for the very least risk.

I encourage our listeners if there's something that they want to do, find people who are already doing it. Duplicate that, it doesn't have to be recreated. Find someone that you trust, ask questions, be as annoying as you want until you get the answers you're looking for, and you have the peace of mind to move forward. Leverage the relationships. We are talking about leverage today, guys, leverage the relationship and find people already doing what you're doing.

Even if you have one more question, some of the people ask this question and many people feel the stock market is risky, they feel a lot of things are risky, especially if they don't understand it. What would you say to our listeners here just wrapping up if they would say, "David, it sounds amazing. I would love to have that kind of return that could enable me to retire much faster, but in the back of their mind they're thinking real estate is risky." How would you respond to that?

David: Oh, well Evan, life is risky, isn't it? Risk is really relative. There is risk in getting up and going to work every day in a car, but we do it knowing that it could be our last day if things don't go right. There is also risk in just putting your head in the sand and doing nothing and hoping for a better tomorrow or hoping that things just change and get better.

I have owned good cash-flowing rental real estate and real-estate-secured notes now for over 35 years. I have experienced down cycles four times, four major down cycles during that time. Evan, the funny thing is that my real estate properties never knew that they were in a down cycle. Why? I wasn't a seller. I was an investor. The rents, that is the cash flow, kept coming in even though the real market value of that property might have dropped 10, 15, maybe 20 percent in some markets. It didn't matter because real estate, particularly single-family houses, is something that everybody needs.

There is not going to be a lack for need of good houses in good neighborhoods. I don't care what the economic cycle is doing. If you learn to buy right, to invest the right way, in the right markets, the right property, again, these are keys we've already touched on today. Those are keys, that we can take a downturn in the market. I know we'll have another reset sometime. I am prepared for it. Why? Because my properties are good. My tenants aren't just going to run out the door and leave just because the economy changes. They will find a way to keep a roof over their head. That is what makes real estate to me so set and secure.

Again, if you buy right, the right markets, buy it with the right financing, have the good management in place, and these are all things you can have done for you by other people not trying to do it all by yourself like we were taught to do in everything else we do in our world and our life today.

Evan: Thank you, excellent. Listeners, if you like what you're hearing, well, click right if you want to subscribe. Please, subscribe. If you don't like it and you're listening all the way this far, what are you doing? Go do something else. It is an honor for me to be a part of this, David. Thank you very much for the call today and I look forward to being on the call again soon.

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