Changing Private Practice Ownership Guidelines: A Response to Increasing Dental School Debt

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Abstract

Ethical responsibility of dental institutions requires building and sustaining the dental health-care work force of the future while providing clinical and management skills for graduates. The American Dental Education Association (ADEA) reported most new graduates would prefer their own practice. However, changing financial requirements and decisions necessary for practice purchase with increasing indebtedness now exist. This altered environment of clinical, administrative, and financial pressures impacts practice opportunities for dental students wishing to own a practice, dental educators encountering new requirements for their graduates, and senior dentists desiring to sell a practice and/or have a transitional associate. Monetary and operational requirement for practice purchase have shifted with increased student debt. New guidelines for practices obtained through convenience consultations with regional professional-loan bankers, university loan officers, transition specialists, practice brokers in the Midwest including the Director of *ADAPT* (American Dental Association Practice Transitions) are presented. Buying larger practices with advanced production skills are now required to repay both student and practice debts with increased financial stress.

Key Words: Banks, Brokerage, Education dental, Dental Health Services, Underserved, Student Loans

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INTRODUCTION:

Dental institutions are practically and ethically bound to build and sustain the dental health-care work force of the future while developing productive clinical and management skills in their graduates. Increased debt load from student loans has provoked necessary changes in both monetary requirements and work experience for obtaining a private practice. Larger practices with enhanced revenues must now support higher total costs of repaying all debt. Increased operating expenses and heightened management abilities are now required.

The AGD (Academy of General Dentistry) reports new graduates are entering the profession believing they may never own a practice because of burdensome student debt with yet additional indebtedness required to buy a practice.[1] Broker sources opined only 5 years ago a new graduate could leave school and immediately buy or assume a practice after a reasonable period of transfer from a retiring dentist. In 2016, the average educational debt of graduating dental students for all schools was just over

$219,000, whereas today the debt load is closer to $300,000. Dental school is currently 16X more costly than 40 years ago while income is only 3X higher. [2]

A survey by the ADEA of 2020 US Dental School Seniors, indicated less than 60% felt prepared to manage a successful business. [3] An American Association of Orthodontists, Resident Graduate Tracking Survey and Student Loan Survey related concerns for lack of business planning knowledge; preparing a ''business model'' for securing a loan; communicating with staff; and operating, managing, and marketing a practice. New graduates showed unease for opening/purchasing a practice associated with high levels of student debt. [4]

While most new dentists would prefer to have their own practice, the perception of financial obstacles may act as an encumbrance to practice acquisition. [5, 6] It is still possible to own a practice and have a reasonable lifestyle. Graduates, educators, and senior dentists wishing to transition their practice need to know the expectations of bankers and brokers.

METHOD:

The recommendations here are a limited perspective; however, sources represent local (Kentucky and Tennessee), and national professionals involved in buying practices, selling practices, and making practice purchase loans regionally and nationally. The individuals are knowledgeable with many years of experience and can provide an example of general guidelines for new graduates. Those concerned should make their own inquiries of banks and brokers. Requirements for purchases are dependent on the circumstances of the individual, locale, and general economic conditions. For example, those consulted were apprehensive about future requirements in an inflationary economy with rising interest rates and institutional and seller guidelines shifting. These recommendations are offered as general guidelines for understanding today's practice ownership requirements. Bankers, brokers, and practice transition sources ordinarily have different views on interest rates, liquidity requirements and expected salaries generated for repayments, as individual company policies necessarily color each source's role in the process. All oral communications have been approved by their contributors with their written permission kept on file.

Advice, considerations, and expectations for achieving practice ownership were obtained by consultation with professional-loan bankers, university loan officers, practice transition specialists, dental practice brokers and the Director of *ADAPT* (American Dental Association Practice Transitions*). (B. Robinson, American Dental Association Practice Transitions, Chicago, Ill. ADA Business Innovation Group, oral communication, January 2021; D. Thacker, Stockyards Bank, Louisville KY, oral communication, January 2021; C. Thieman, Practice Brokerage ARGY Financial Group, oral communication, Louisville, KY, March 2021; J. Gursky, Henry Schein Dental Supplies (nation-wide company), oral communication, Louisville, KY January 2021; J. Bruder, Vice President Physicians Capital Lender, Memphis Tenn. (nation-wide coverage) l, oral communication, January 2021; K. Alexander, (Practice Transition Specialist, Carlsbad, CA) oral communication, January 2021 K. Murtha, ADA Business Innovation Group, Chicago, Ill. (nation-wide coverage) oral communication, January 2021 . D. Brown, Financial Aid Coordinator, Academic and Student Affairs, University of Kentucky College of Dentistry. Oral and Written Communication September 2021).*

RESULTS:

Current requirements to purchase a practice are important for dentists wishing to own a practice, for dental educators meeting changing requirements for graduates, and senior dentists desiring to sell a practice and/or have a transitional associate. Understanding these experiential and financial requirements allows planning for enhanced clinical and management skill sets needed for practices large enough to support students' heightened debt.

Students' debt-to-income ratios are scrutinized by bankers to determine appropriate loan size. As student debt has increased, income also needs to increase, requiring purchase of larger practices. Total repayments of student and practice debt need to be balanced by a larger income. In this regard, it is important to make the appropriate choice among student loan repayment methods that will *maximize cash flow and improve debt-to-income ratios*. School financial aid coordinators should recommend a blueprint to meet individual needs as many repayment plans including government, commercial and ADA associated loan programs, etc. exist. [6]

Repaying school debt may affect where one works. In the US, Health Provider Shortage Areas (HPSA) areas contain 61,900,000 people with 31% of dental needs met. Inequitable distribution of dentists in the US are due to economic, cultural, and other factors with a shortage ratio of 5,000 to 1. Bringing to parity, 10,800 more dentists are needed to fill this gap. [7,8] Federal Health Provider Shortage Area facilities present reasonable salaries with $50,000 in debt cancellation for an initial two-year contract, and $20,000 cancelled each year of contract extension in the National Health Service Corps. [9]

Reducing tuition debt:

A way to pay back student loans, gain work experience, and build liquidity to buy a practice is to work for a public entity and combine Public Service Loan Forgiveness Program (PSLF) with an Income Based Repayment Method. Under the College Cost Reduction and Access Act of 2007, Federal student loans may (currently) be forgiven tax free for those serving the public and in education. Under the PSLF program, graduates have their debt and unpaid interest forgiven tax free after 120 months of full-time employment with a qualified employer.

Increasing tuition rates have motivated dental schools to undertake a partial remedy by reducing indebtedness for its students with efforts to reduce costs. For example, the University of Kentucky (UKCD) obtained $1,578,509 in federal grants and raised scholarships from many sources for 195 dental students in 2020-2021, reducing tuition costs. This dropped tuition an average of 12% for recipients. Grant and scholarship recipients typically requested their Federal Grad PLUS Loans be *reduced*. An aggressive education policy through serious financial counseling, avoids consumer-oriented "over-borrowing" from student loan sources, stressing frugality and savings.[12] The Department of Education requires all schools to provide a Financial Literacy Program which typically includes aspects of practice management in the dental curriculum. The American Dental Education Association (ADEA) reported an average indebtedness for all US schools public and private of $304,824 for the Class of 2020.[10] By reducing tuition and controlling costs, an average UKCD graduating student debt is $20K under the national average for the Class of 2021, with In-State student debt only

$227,289.[11] This institution recently assisted in acquiring 26 Federal PSLF positions for its students, allowing additional tuition forgiveness.

Current Banker Requirements.

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1) *Production History:* New dentists must possess clinical skill, practice speed, and administrative capability to run a sizable practice able to support itself and repay debt. Bankers we queried currently expect a successful work history with two to three years of experience. Bankers also require knowledge of how much gross production was performed during this period.
2) *Seller's Profitability:* To be able to have enough profit to repay loans, banks demand the practice *seller's* percentage of overhead and profit/loss tax reports for 2-3 prior years to determine if the practice is a viable one. An overhead of circa 55-60% is expected for an active general practice, while an overhead of 60-65% is more characteristic of an older or senior practice.
3) *Personal Financial History:* Bankers want confidence that a borrower is a responsible party. Up to 24 months of personal financial history may be examined.
4) *Indebtedness*: Fortunately, it is not the *total amount of indebtedness* which determines whether a loan for a practice is made, but the *debt-to-income ratio* which is scrutinized. As loan payments increase, income needs to increase as well. Therefore, it is important to choose a student loan repayment plan that minimize the size of repayments, and purchase of a practice which maximizes income.[6]

5) *Current Liquidity Requirements, Cash Available to Support Operations:* Liquidity requirements vary from bank to bank and change based on prevailing economic conditions. The liquidity a purchaser possesses will affect the interest rate of a loan used to buy a practice. In general, a purchaser with more liquidity represents less risk to the bank, hence a lower interest rate on the practice loan. Sources of liquidity may include spouse's income, parent or a relative's co-signature, brokerage accounts available, etc. Since larger practices need more operational dollars, the required liquidity varies based on practice revenues. Current requirements varied extensively from 5-30% of the purchase price. Before obtaining a loan at a reasonable interest rate (currently circa 2.8 to 3.5 %) a purchaser must show enough money is available for practice operations. Currently, we found some institutions will grant a loan with almost no liquidity but with a correspondingly high interest rate approaching 4 - 5 1/2 %.

6) *A Business Plan:* Business schools commonly include operational business planning projects in their curricula. Dental educators may well consider developing a business plan for purchasing a practice in the curricula as well. Bankers are rigorous, requiring a comprehensive "business plan" projecting: practice gross and net income, employee payroll/salaries (including self), health and business insurances, supply purchases, equipment/maintenance, physical plant (air conditioning/heating-gas and electric), office rents, taxes, marketing/website, consultant, accounting, legal consultations, and unspecified operating costs. An inventory of all clinical and non-clinical equipment, including supplies for purchase are obligatory. A monthly personal budget including student loan repayments, personal living expenses, transportation, housing, food, and clothing, etc., are all planning features.[12]

Current Transition Consultant and Broker Expectations:

1) Purchasing a *busy and profitable* practice means that the purchaser immediately gains a raise because the entire net of the practice goes to the practitioner rather than being split with an employer. The price of a practice is based on gross income and depends on profitability which may vary from state to state and location. Currently, less favorable practice locations may sell for as little as 60% of gross. Other factors affecting profitability include the primary patient insurance base for the practice, practice age, newness, operability of equipment, current sterilization facilities, modernity of the office furnishings and general impression, etc.

2) Approximating the amount of *remaining* work to be performed on existing patients as indicated in the record base is crucial when determining possible future profitability of a purchase. For example, when comparing high or low grossing practices, both may have the same number of viable patients, but with a high grossing situation having *already* performed most needed treatments. In some senior practice situations, the seller may have performed only base patient management as retirement approached. The latter situation with lower gross production but ample treatment yet to be performed and a lower price can be the greater asset. The practice broker or transition specialist helps with this determination.

3) We found average practices for sale can gross $700,000 – $800,000, with a sale price typically 65 - 70% of gross receipts. Purchase costs may lie between $450,000 – $560,000. For higher grossing practices, e.g., $1,000,000, the price may range from $650,000 to $700,000. As net receipts of a practice determine the dentist's income, a busy, higher grossing practice (at higher cost and bigger patient load) is needed for sufficient cash-flow income to pay all student debt and practice debt. Consultants we spoke with indicated today's graduate servicing a high level of debt may require a *net* income of circa $300,000 - $400,000.

4) Avoid bank loans with *"floating and variable interest rates".* Currently, interest rates are low and with diligence can allow repayment of *all* debt. Because of high levels of student loan and practice debt, even a modest rise in interest rates makes management of dual repayment of school and practice debt more difficult.

5) When considering "sweat equity" or *salary differential* to purchase a practice, brokers opined that only 20% of practice purchase situations are completed if a pre-work/purchase contract is not *first* established. In this plan, one is paid less salary while working in the practice to be purchased. The salary differential being applied to the price. When entering a *work-then-buy* situation, it is advisable to establish the buy-in amount in writing beforehand. If efforts as a new practitioner cause practice value and gross receipts to substantially rise, it is unreasonable to pay the difference at the time of final purchase.

6) DSO's often wish to earn at least a 12-20% margin of profit from the work of dentists employed (this varies with state and location). Some DSOs "claw-back" salary if production goals are not met. When the employee dentist earns less than a certain percentage of gross income, the new dentist may in fact owe a percentage *back* to the DSO of what was paid as salary, adding to the burden of indebtedness.

7) It's critical to check the *non-compete rules* of the DSO before employment. One may not purchase the future private practice desired if lying geographically too close to the employing DSO location. Contracts should be checked with an attorney.

CONCLUSION

The recommendations of consultants interviewed are offered for consideration. For those interested in owning their own practice with high levels of student debt, advanced clinical skills and financial management expertise is now required to operate necessarily larger practices. Meeting rising economic challenges for their graduates, schools may consider additional training in clinical speed, administrative ability, and financial management ethics. Consultation with dental-knowledgeable brokers, bankers, attorneys, and accountants is recommended for those seeking a practice.

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Bruce Haskell is Professor, (part-time), Department of Orthodontics, University of Kentucky College of Dentistry and operated a successful private practice for many years before its sale. He is former Chair of the American College of Dentists for Kentucky. Dr. Thomas Keefe is Emeritus Professor of Business at Indiana University Southeast

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