Chapter 17:
Financial Planning

You Are a Financial Manager
Throughout your career, you will assume the role of financial manager, as well as practitioner. As a good financial manager, your tasks are to maintain good credit standing, manage your business and personal income and debts, plan for savings and retirement, and more.

Inevitably you also will need to borrow money. Early in your career you may want to consolidate educational debt and move into practice ownership – whether starting a new practice, buying into or acquiring a practice. Later, you may seek to expand an existing practice, build an entirely new one, or even combine two practices. You may even want to consolidate all of your business debt into one loan.

Regardless of what kind of practice or lifestyle you intend to pursue, good financial planning with a regular assessment of your situation will ensure that you build a strong foundation for personal and practice success.

(Further information on this topic can be found in Practice Options for the New Dentist: A Financial Guide available through the ADA Catalog.)

Your Financing Resources
You have a number of financing options when you borrow money to invest in your practice. There are traditional financial institutions such as banks, as well as other sources including specialty finance companies that specialize and focus in the dental industry, the Small Business Administration (SBA), and family and friends.

Banks generally require a down payment of at least 20% of the total project cost or practice purchase price. (SBA lenders require a 10% down payment.) In reviewing your loan application, a bank or SBA lender typically wants to see positive net worth, historical cash flow for repayment of the loan and a strong personal credit history. If you seek a lender who is familiar with your community and you are well established, a local bank might be a wise choice.

Whereas your local banker may be an expert on your community, a specialty finance company is an expert in financing dental practices and can act as a valuable business resource. These specialized lenders provide up to 100% financing and generally grant loans to both established doctors and beginning practitioners who often do not have a high net worth or a history of cash flow. For doctors seeking to start their first practice, specialty finance companies look at personal credit history and the practice potential by evaluating cash flow projections based on a business plan.

A good lender understands your particular financing needs and works with you to put together the right financing program for you. If possible, choose a lender that does not charge an origination fee, a loan closing fee or heavy documentation fees.

Before signing on with any lender, however, some questions to ask are:

• Does the lender understand the specific financing needs of dental professionals?
• Will the lender consider cash flow based on projection?
• Will the lender provide up to 100% financing?
• Will the lender give you payment options for your loan?
• Does the lender have experts on staff to help you identify key issues within your practice to improve productivity and profitability?

Once you’ve determined what you want to do and how much you’ll need to borrow, your next step is to have lenders qualify you. They should be able to tell you the amount they’ll lend based on what they believe will be your ability to repay the loan.

Selecting the Right Loan
Upon submission of the appropriate information, your lender will approve a loan for a specific amount. As part of your planning, you must allocate working capital funds towards the overhead.
of running a dental practice including equipment and supplies purchases as well as compensation for personnel.

In developing your loan request, the amount you borrow should be sufficient to cover the purchase of the practice itself plus potential new equipment and supplies, leasehold improvements and operating costs until the practice generate sufficient cash flow.

Commercial loans are generally short-term loans for three to seven years. The interest rate should be competitive, and you should also carefully consider the terms of a loan offer. Rates may fluctuate according to the prime-lending rate. Repayment schedules vary widely and can be structured to assist the dentist in the first years of the loan. Your lender may provide deferred payment plans with no payments for the first several months of the loan term, or the lender may allow interest only or graduated payments for the first year or two of the loan. You might wish to propose a favorable repayment schedule as part of your pro-forma statements. Where you get your loan will affect the terms and restrictions, so it is important to choose a lender that understands your business and will work with you.

Many banks require something of value pledged as security, in case the dentist cannot repay the loan. The collateral could be a “co-signature” by a family member, the dental equipment, or even a second mortgage on the dentist’s home. The best loan is one in which these factors, properly mixed, meet your own objectives and resources. Based on those needs, be sure you borrow enough initially so that you don’t have to return for additional amounts. Regardless of which type lender you choose, you want to show a strong credit history and a business plan.

It is never too early to begin building good credit.

Building Good Credit
Whether you’re an experienced practitioner or a recent graduate, your personal credit rating is the best indicator to a lender that you have responsibly managed your obligations. It is never too early to begin building good credit. You can maintain a favorable credit record by making on-time payments on mortgage, student, revolving credit or installment loans, even if you only make the minimum payment. Also, avoid co-signing on loans for others or falling behind on tax payments. When the time comes to apply for a business loan, avoid submitting multiple applications for that loan or applying for additional loans during the approval process. A lender who sees that your credit has been pulled by multiple lenders might see you as a credit risk, even though you have a history of making on-time payments.

Developing a Business Plan
Most lenders require a business plan for start up and expansion practice projects. A business plan is not only vital to securing financing; it is your blueprint for a successful practice.

A formal business plan has three parts: the executive summary, narrative and the financials. The summary is the first thing a potential lender will read, and must be persuasive, explaining why you are uniquely positioned to make your business a success. The narrative offers an overview of your business for at least one year into the future. It should describe the legal structure of your practice, the services and types of dentistry you plan to offer, staffing, management plans and practice goals, among many other things. The financials include an income statement, cash flow forecast and balance sheet, along with appendices providing backup information. Add any charts or graphs to represent data or items mentioned in the narrative or financial sections, which might include demographic information surrounding the area for which you will or are currently practicing. Also include your resume (see below), as well as actions plans, timelines for opening and growing your practice, fee schedules and an organization chart.

If you are acquiring an existing practice, you will need a transition plan that focuses on retaining the current patient base and the ongoing management of the practice. Specialized lenders that focus on dental professionals often provide assistance in developing the business or transition plan.
Loan Documentation
The following information should be developed and provided to a lender for evaluation. Your loan request package should include a summary specifying the amount being requested, what it will be used for and the terms desired; a financial statement; your resume; a personal budget; cash flow projection for the practice; description of items and services to be purchased with proceeds from the loan; management and marketing plans; and an appraisal if the practice is being purchased.

Loan request: This is a statement of how much money is requested and a summary statement of how the finds will be used. Be specific: cite equipment and dental instruments purchases, dental supplies, leasehold improvements, and/or operating capital.

Resume: This is an organized autobiographical summary of your life. Highlight your work experience, with particular attention to military service, management and/or supervisory experience. Focus on activities the lender can relate to.

Practice objectives: Let the lender know where you see yourself professionally in the next five to seven years. Do you intend to stay in an associateship, or do you want to have a solo practice? Do you want to build and own your own building?

Practice location: Describe the other health services in the area as well. Are there new subdivisions? How many other practitioners? Consider investing in a demographic report of your practice’s neighborhood.

Pro-forma financial statements (Projections): These standard accounting schedules are estimates of your income and expenses for the next year. The revenue estimate is based on the number of patients you predict you will see each month, multiplied by an average fee per visit. Expenses are based on your research of expenses incurred by dentists in similar practice environments and locations close to where you intend to practice. Expenses are defined in terms of those categories relevant to a dental practice. Monthly data is combined to form a quarterly analysis. The pro-forma statement is not a “wild guess” but an estimate that if carefully done, will be 90% - 95% accurate. The same approach is used to develop information for your personal income and expenses.

Seller financials: In the case of a practice acquisition you would obtain financial statements from the seller for the past two to three years.

Personal Financial Statement: Each lender will have its own form, with slight variations, usually in the order of the entries on the page.

Working Capital Assessment: For a practice start up project, your practice expenses may be greater than your income for the first six to eight months. This justifies the necessary operating capital that is part of the loan request. You should, as well, establish a salary for yourself at the very beginning so that you can meet your own personal financial obligations.

Insurance Requirements: Most lenders request that you take out a life insurance and disability policies to protect both the lender and your estate should you die or become disabled while the loan is outstanding. The ADA term policies are an excellent choice to fulfill this requirement.

Owner Financing and Assistance
If the owner of an existing practice is helping you buy into the practice you should weigh the advantages and disadvantages of this type of financing. Determine how much should be carried, if any, and the terms of such an arrangement. The arrangement should protect your interests and make provisions for early payoffs. Work with the appropriate advisors, including a CPA regarding tax implications.

If the seller is assisting you in obtaining non-owner financing, he or she should share information including projections of revenue and expenses and sources of financing, perhaps meeting with you and representatives of financial institutions. The seller should work with you to determine an appropriate transition period and management plan.
Considerations
With different resources available for practice financing, select the lender that offers you the most effective financial solution and future success. It is critical that you pay attention to all terms and conditions in addition to the interest rate. Also consider your lender’s experience in your market and whether they support you throughout your career.

For more information on acquiring loans for practice acquisition, start up, equipment leasing, or debt consolidation, call ADA Member Advantage’s endorsed provider, Matsco at 888-937-2321. Matsco provides free educational tools and materials, including the article Start-up or Acquisition — What's Right For You? Available at www.matsco.com/news

Retirement Savings Programs
It will be to your advantage to establish a retirement savings program as early in your career as possible. Social security benefits will hardly be adequate to maintain your standard of living in your years of retirement; and ordinary savings and investments offer no tax advantages.

There are a variety of ways in which dentists can save and invest for retirement on a tax-advantaged basis. But most experts agree that the best way is through the use of “tax-qualified” plans—a category that primarily includes pension plans and profit sharing plans. However, for a limited number of dentists, a defined benefit pension plan may also be beneficial. Each of these plans may also be supplemented by an Individual Retirement Account (IRA).

Tax-qualified retirement plans
Under a tax-qualified retirement plan, the employer dentist makes a contribution on his or her own behalf and for all other full-time employees meeting certain criteria. The dentist may not take advantage of these plans unless he or she includes any eligible employees. Dentists who are employees of other dentists or companies may not take advantage of a tax-qualified plan.

However, an IRA may be a viable alternative for these dentists who are not self-employed.

Not all IRAs are equal. Which IRA you select, and how you’re able to invest the money you contribute can significantly impact your financial future. The ADA endorsed 300+ Series IRA offers:

• A complete range of IRA options
• Experience with the needs of ADA Members.
• Diversified Investment options
• 24/7 Access to your account

* The 300+ series IRA is funded by a group variable annuity contract issued and distributed by AXA Equitable.

Contributions to tax-qualified plans are treated as a tax-deductible business expense for a dental practice. Combined with the advantages these plans offer for the employer dentists themselves, the tax-deductibility of contributions make these plans an affordable and desirable benefit to offer dental office employees. In a sense, by reducing the dentist’s taxes, the federal government is helping to offset the cost of offering a retirement plan as a benefit for the dental office’s employees. Money that is contributed on behalf of an employer dentist or dental office employee is not taxable to the individual until it is withdrawn from the plan. Investment income earned on these contributions is also not subject to current income taxation.

Depending upon the type of plan, withdrawals from tax-qualified retirement plans may or may not be permitted prior to retirement. If permitted, such withdrawals may be subject to a 10% penalty and immediate income taxation if taken prior to age 59 1/2. After age 59 1/2 withdrawals are no longer subject to the 10% penalty, but will be subject to income taxation. Withdrawals must commence not later than age 70 1/2. The structure and operation of tax-qualified retirement plans must meet strict guidelines and be submitted to the Internal Revenue Service (IRS) for approval. Loss of such approval could result in the immediate taxation of all contributions made to the plan.
Rather than incurring the expense of developing a tax-qualified retirement plan and filing it with the IRS, most dentists adopt a “prototype’ or ‘master’ plan. For example, the ADA Members Retirement Program offers a master plan and a volume submitter plan that are pre-approved and kept in compliance with changing tax laws.

The profit sharing plan is the most popular type of retirement plan among dentists as it permits an enormous amount of flexibility, including the addition of a 401(k) arrangement. Under current regulations, the employer/dentist has complete discretion to determine the amount, if any, of a profit sharing contribution to be made in a given year. Contributions may also vary according to the availability of profits or retained earnings from a dental practice. The maximum aggregate employer contribution to a profit sharing plan is 25% of the annual compensation of all participants in the plan. However, the maximum contribution for the dentist cannot exceed the lesser of 100% of compensation or $45,000 (2007 limit). A dentist could maximize his contribution while keeping employee cost down by using a 401(k) feature, social security integration or by adopting a new comparability plan, all described below.

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Through a technique known as “social security Integration or permitted disparity” profit sharing plans can be designed to increase the proportion of the practice’s total contribution allocated to the dentist. When a plan is integrated, all eligible participants in a dental office will receive a basic contribution. However, the employer dentist will receive an additional contribution. It will be based upon income the dentist earns that is in excess of the integration level set by the dentist, generally just above the earnings of the highest paid employee.

A 401(k) arrangement may also be added to the basic profit-sharing plan. Under a 401(k) arrangement, both the dentist and dental office staff may make additional contributions on a pre-tax basis or as designated Roth contributions. A designated Roth contribution feature permits 401(k) contributions to be made on a post-tax basis. These Roth contributions can be withdrawn tax-free if it is considered a qualified Roth distribution. A qualified Roth distribution is one that is made at least five taxable years after the first designated Roth contribution is made under the plan and after attainment of age 59 \( \frac{1}{2} \), death or disability. However, the total contribution to the plan, including the 401(k) allocation, integration and the basic contribution, cannot exceed 100% of any participant’s compensation (as defined in the plan). The ADA Members Retirement Program also offers variations of the traditional 401(k) product. These are the SIMPLE 401(k) and Safe Harbor 401(k) plans. Both plans can include the Roth 401(k) feature.

SIMPLE 401(k) plans can be easy to administer. These plans are not subject to the “discrimination testing” or “top heavy” rules that apply to regular 401(k) plans. You can contribute to the plan even if your employees decide not to participate. In a SIMPLE plan, you and each eligible employee can make pre-tax elective contributions up to $10,500 annually (2007 limit). Each year you must offer your eligible employees who participate a dollar-for-dollar matching contribution up to 3% of compensation. If you choose the 3% contribution requirement, eligible employees who do not participate receive no contribution from you. The other alternative is to give a 2% contribution to all eligible employees regardless of whether they make pre-tax elective contributions. All contributions are made on a pre-tax basis, and any matching or non-elective contributions made are tax-deductible to your business.

The other alternative to a traditional 401(k) plan is the Safe Harbor 401(k). A Safe Harbor 401(k) Plan can be a hassle-free, tax-advantaged way to defer the most income for your retirement — up to $15,500 (2007 limit). It’s easy to qualify and even easier to administer. You can choose one of two contribution requirements — either the non-elective contribution equal to 3% of compensation for all eligible employees — regardless of their participation or a matching contribution that is equal or better than 100% up to the first 3% of compensation and 50% of the next 2% of com-
Professional advisors such as certified financial planners, attorneys and accountants provide advice on retirement plans. New comparability plans are plans that are designed to take advantage of cross-testing. Cross-testing simply means that the contributions are tested on the basis of benefits at retirement age rather than on the basis of amounts contributed. Because they are tested on the basis of benefits, these types of retirement plans take into account the ages of participants, and can therefore be more beneficial for older employees than profit sharing plans that use a pro-rata formula or even an integrated profit sharing formula.

Where to seek advice
Professional advisors such as certified financial planners, attorneys and accountants provide advice on retirement plans. The fee for their services will usually depend upon the complexity of the plan you are seeking. Banks, brokerage houses and insurance companies offer prototype or master plans as well as general information about the types of plans available and their costs.

ADA resources
The ADA Members Retirement Program was established in 1968 to provide ADA members and their employees with tax-qualified retirement plans. The Program currently has nearly $1.6 billion of invested assets and is administered by AXA Equitable. Investment management services are offered by a variety of firms including Alliance, Bernstein L.P., Fidelity Management Research Company, Templeton Global Advisors Limited, The Vanguard Group, Dodge + Cox, Janus Capital Management LLC, Wells Capital Management, Inc. and Western Asset Management Company, a Legg Mason Company.

Pension for those employees that participate. You must provide a notice at least 30 days but not more than 90 days before the beginning of each plan year indicating which type of contribution you will make for the coming plan year. Unlike traditional 401(k) plans, there is no nondiscrimination testing for the Safe Harbor Plan.

Annual salary increases to the salary deferral limits for traditional, Safe Harbor and SIMPLE 401(k) plans are tied to the cost of living increases. Participants over age 50 can defer an additional $5,000 (Traditional, Safe Harbor 401(k)), or $2,500 (SIMPLE 401(k)) in 2007. This amount is called a catch up contribution. Annual increase to these limits are also tied to cost of living increase.

As a business owner — even with no employees — the Owners 401(k) allows you to put away significantly more pre-tax dollars than you could in the past, without costly plan set-up charges. What’s more, if you’re worried about affordability, the Owners 401(k) gives you the flexibility not to contribute in a given year, because each year the funding of the plan is completely at your discretion.

In addition, the Owners 401(k) Plan allows you to:

- Generate tax deductions that are more than twice as much in some cases than with traditional business retirement plans, such as profit sharing plans, money purchase plans, SEP plans and SIMPLE plans.
- Consolidate retirement assets from your IRAs, 401(k), 403(b), or other qualified retirement plans into one, convenient account.
- Contribute even more if you’re 50 years of age or older.

To determine if an Owners 401(k) Plan is appropriate for you please consult with one of our Retirement Program Specialists at 800-523-1125. If you wish, you can receive a customized retirement plan proposal from an ADA Members Retirement Program Specialist at no cost or obligation to you.
The ADA Program offers an IRS-approved defined contribution master plan and a volume submitter plan that have been developed to meet the special needs of dental offices. The Program includes a full service arrangement including a Program website with processing and reporting of financial transactions and quarterly statements of invested assets. Consulting services are provided on all aspects of the program, as is information on investment performance and counseling in selecting retirement benefit options. The ADA Program offers a wide variety of options for investment of participant contributions. They include a growth stock fund, aggressive stock fund, balanced fund, international stock fund, S & P 500 Stock Index fund, conservative asset allocation fund, moderate asset allocation fund, large cap value fund, small cap value fund, bond fund, money market fund, plus a series of fixed income accounts that guarantee both principal and interest. All investment options are available for use either in conjunction with the ADA master or a volume submitter plan or with an investment only arrangement plan.

For information on the ADA Members Retirement Program, call the administrator, toll-free at: 1-800-523-1125.