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Are You a Gambler?

variables of shopping for a dental loan

You're finally ready to own your own dental practice. **Congratulations!** Whether your preference is to develop a scratch-start or purchase an existing office, you are going to need money, lots of it, and this will likely be the largest investment of your entire life. This article will discuss some of the important questions you should ask as well as points to consider when shopping for a dental practice loan.

Typically, the first question asked by any borrower is, "What will my interest rate be?" Although a good barometer, it is much more important to inquire, "What will be the total cost of my loan?" and "What will my monthly payment be?" More on this later.

Unless you have wealthy generous relatives who consider you their favorite, the two most common sources for dental loans are generally banks and healthcare finance companies. There are many differences between the two. Once you understand them, it will be easier for you to choose which best suits your needs. Let's look at some of these differences.

Variable #1

Most banks offer a variable floating rate, a fixed percentage over the Prime Rate, which will fluctuate up or down with the Prime Rate. [The Prime Rate is the interest rate charged by banks to their most creditworthy customers -- usually the most prominent and stable business customers. The rate is almost always the same amongst major banks. Adjustments to the Prime Rate are made by banks at the same time; although, the Prime Rate does not adjust on any regular basis. *Source: www.nfsn.com/library/prime.htm*]

Healthcare finance companies offer a fixed rate with simple interest. This rate will not fluctuate, regardless of changes in interest rates. Healthcare finance company rates will be initially higher than you will receive from a bank. Can you afford to wager a bet that interest rates will not rise above the level necessary to cost you substantially more for your loan than if you had a fixed rate? When you assume the risk with a variable floating rate, the bank is covered. When healthcare finance companies assume the risk with a fixed rate, you're covered. Your payoff with a fixed rate is the security that your monthly payment won't change.

Variable #2

Many banks will usually ask for 10-20% down payment of the amount borrowed on the loan. This alone will eliminate most young dentists still paying off large school debts. Healthcare finance companies require little or no down payment.

Variable #3

Many banks typically ask for collateral such as a home or property. In most cases, healthcare finance companies will use the dental equipment or practice as collateral.

Variable #4

Bank loans and most healthcare finance companies can tie up your credit line for future purposes such as personal loans. At least one healthcare finance company doing business in Arizona today will keep business and personal credit lines separate as long as you don't default. If you decide to purchase a home, your business loan will not appear on your credit report.

Variable #5

Banks add points to cover closing costs, attorney fees, etc. Healthcare finance companies have a minimal fixed rate filing fee. These closing costs will increase the bank's adjusted annual percentage rate (APR) when compared to a fixed rate.

Variable #6

Funding a bank loan can involve miles of red tape and tons of paperwork. Funding with a healthcare finance company can be as simple as a phone call, with minimal follow-up paperwork. There is a reason for this.

Healthcare finance companies specialize in dental loans. They know that less than 1% of dentists "crap out," or default, on these loans. Commercial loan bankers view you as "new business" and their default rate is many, many times higher. So, they need to be more cautious. For example, a typical day in the life of a loan officer might involve meeting with someone who wants to borrow money to open a tanning salon. The next client wants to open a pizza parlor, the next dreams of operating a pet grooming boutique. The point is, when applying for a commercial loan, you will need to prove to a banker not necessarily familiar with the dental business that you "know when to hold 'em, know when to fold 'em" and therefore won't default. Additionally, many banks, and some healthcare finance companies, will also require life and disability insurance coverage as a prerequisite for loan approval.

Variable #7

A very important determination to make is whether prepayment penalties apply, and for how long they apply. This varies throughout the industry.

When financing a fixed rate mortgage, by law the lender must provide you with a "Truth in Lending Statement." This will explain the adjusted annual percentage rate (with closing and other costs factored in). More importantly, it explains exactly what the total cost of your loan will be over the life of the loan. When banks offer a floating variable rate, they are unable to tell you what the total cost will be because it's impossible to predict interest rates. That's the gamble you take.

Healthcare companies with fixed rates can tell you exactly what your total cost will be. However, they are not required to and they generally won't volunteer the information. So, insist on it. This becomes even more paramount if someone is offering you a 15-year loan as opposed to the standard 10-year loan. The monthly payment and interest rate may be lower for the 15-year loan but at what cost?

Ask what the total cost of your loan will be based on 15 years and on 10 years. Compare the two and see whether you can afford the luxury of a lower monthly payment. Remember -- less than 1% of dentists default on dental practice loans.

Time to Bluff?

You could bluff and sign up for a 15-year loan, enjoy the luxury of lower monthly payments for the first year, then accelerate your principle payments. I wouldn't suggest bluffing unless you are disciplined enough to pay off your loan in 10 years or so. If you are not disciplined enough, this bluff will cost you a very large pot (see variable #7). NOTE: This strategy only applies if all prepayment penalties are waived after one year!

Final Thought

When I borrowed money for my new office in the early 1980s, my floating variable interest rate peaked at 23.5% -- yes -- you read it right! As recently as May 2000, the Prime Rate peaked at 9%. So, a floating variable interest rate would cost you 11-12%.

At the time of this writing (June 2004), interest rates are at a 46-year low (refer to chart) and they're likely to go higher by the time you read this. How high, no one knows. That's the gamble. Can you afford to ante up?

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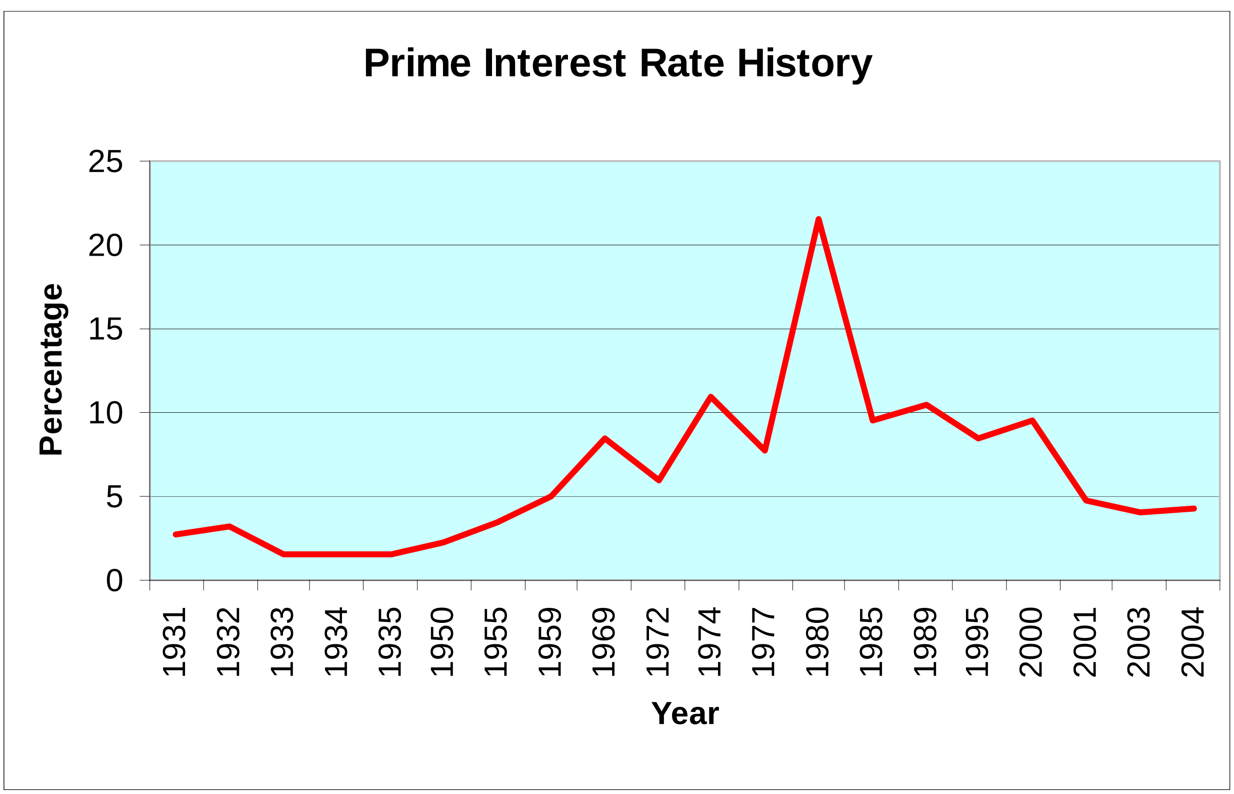

A complete history of the specific dates on which the Prime Rate changed can be found online at http://research.stlouisfed.org/fred2/data/PRIME.txt