BENCO DENTAL | WHITE PAPER

Rich Dentist, Poor Dentist:

How Smart Dentists Use Real Estate to Build Wealth

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Partnered with:

CWA CAIN WATTERS & ASSOCIATES

01 Abstract

> **'YOU DON'T SEEM TO REALIZE WHAT BUSINESS YOU'RE IN. YOU'RE NOT IN THE BURGER BUSINESS, YOU'RE IN THE REAL-ESTATE BUSINESS. YOU DON'T BUILD AN EMPIRE OFF A 1.4% CUT OF A 15¢ HAMBURGER. YOU BUILD IT BY OWNING THE LAND UPON WHICH THAT BURGER IS COOKED."**
>
> - Future McDonald's CFO Harry Sonneborn to CEO Ray Kroc, as quoted in *The Founder* (2017)

All dentists know that they are in the tooth construction and reconstruction business. But the smartest dentists know that they are also in the real estate business. The only question is: for their practice, and them personally, will real estate be an *investment* or an *expense*?

Many books have been written about the right methods for investing in real estate. But this paper is different: it outlines a methodology for dentists to invest properly in the real estate under and around practices they own and/or operate.

Topics include: basic principles of real estate investing; how dental real estate differs from other real estate investments; ideas for how dentists can increase their personal wealth and practice options by owning dental real estate; and first steps in the process.

DENTAL REAL ESTATE: A DEFINITION

For purposes of this paper, the term *dental real estate* refers to land and buildings that are used by dental practices owned and operated by a dentist, and is used to differentiate from general real estate investments.

02 The Basics of Real Estate For Dentists

INVESTING IN REAL ESTATE IS THE SUBJECT OF MANY BOOKS AND CLASSES.
Here are a few of the basic principles behind real estate investing.

REAL ESTATE OFFERS SIGNIFICANT TAX INCENTIVES.

From tax deductions offsetting rental income, to preferred treatment of capital gains, to annual depreciation, real estate has long been viewed as one of the most tax-advantaged assets to own.

BANKS WILL LEND WITH REAL ESTATE AS COLLATERAL.

Banks view commercial properties with a long-term tenant as stable, lendable assets, so owning real estate makes it easy to borrow cash through a long-term mortgage, even for young dentists struggling with student debt. And mortgages can be refinanced every few years to take advantage of interest rate changes, or to diversify into other investments.

OWNING REAL ESTATE IS A GREAT WAY TO BUILD LONG-TERM WEALTH.

Like every asset class, commercial real estate values can fluctuate from year to year. But over the roughly two decades from 1998 to 2018, U.S. commercial real estate values more than doubled, increasing twice as fast as inflation over the same period.[1]

OWNING PRACTICE REAL ESTATE ALLOWS A BUSINESS OWNER TO CONTROL THEIR OWN DESTINY.

Landlords know that moving a business is expensive and disruptive, so they sometimes use that threat to increase rent as leases approach renewal. Successful businesses want the certainty that comes with owning their location.

THE REAL ESTATE MARKET IS LOCAL.

National trends in valuation and interest rates will always be a factor, but successful commercial real estate investors know that real estate is inherently a local business, with values directly reflecting activity in the local market. Dentists who own their own building understand the community in which they are investing.

FOR MOST PROPERTIES, A RENTER CAN 'OWN' THE PROPERTY AFTER 10-12 YEARS OF RENTAL PAYMENTS.

The '1% Rule' indicates that monthly rents should be set at roughly 1% of a property's value (i.e. the monthly rent for a $1 million property should be about $10,000.) So a renter could have 'bought' the building after paying rent for roughly 10 years. That assumes a 4% interest rate on a building loan. By purchasing the real estate, you build equity which will continue to generate income and potentially increase in value vs. having nothing at the end of a lease. Of course, this calculation is an oversimplification, and used here only to illustrate that long-term tenants are often better off buying a property than paying rent to a landlord.

[1]*Source: https://www.greenstreetadvisors.com/insights/CPPI*

03 How Dental Real Estate Is Different

ON THE PREVIOUS PAGE, WE OUTLINED SOME REAL ESTATE BASICS THAT A DENTIST SHOULD UNDERSTAND. Below are some of the peculiarities that make dental real estate different (and better) than other commercial property investments.

DENTISTS ARE AMONG THE BEST TENANTS: THEY RARELY GO OUT-OF-BUSINESS, AND HATE TO MOVE.

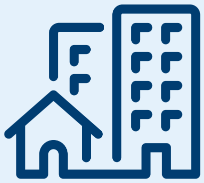
The key to a successful commercial real estate investment is having a stable tenant who pays the rent on time. A dental practice generally has strong cash flow, invests significantly in tenant improvements, and the equipment is expensive and difficult to move.

DENTISTS ARE IDEAL TENANTS FOR ‘B-RATED’ LOCATIONS.

Real estate investors commonly use a rating system for locations that ranges from A (most expensive and desirable) to C (cheapest and least desirable). Where Starbucks or Home Depot might be looking for an ‘A’ location with high visibility and proximity to main arteries, a dental practice is a ‘light retail’ business that’s perfect for a ‘B’ site just around the corner from an ‘A’ location, perhaps at a slightly less-busy corner. Key for a dental practice is room for a tasteful sign and easy vehicle access from either direction. By choosing a ‘B’ location, a dental practice can have better visibility than a ‘C’ site, without paying ‘A’ prices.

OWNING TWO SEPARATE ASSETS, THE PRACTICE AND THE REAL ESTATE, ALLOWS MAXIMUM FLEXIBILITY IN BUILDING AND TRANSITIONING WEALTH.

Keeping assets separate allows the dentist/owner to bring in a younger associate who can purchase the practice, with the flexibility to sell the real estate, simultaneously or separately, retaining the stable rental income for a period of years. Similarly, if the dentist/owner passes away suddenly, the family can quickly transition the practice to a new dentist and choose to sell the building with the practice, or keep it, and the associated rental income, for a period of time.



04 Common Mistakes in Dental Real Estate

FIVE COMMON MISTAKES

As with every investment, dental real estate has a few potential pitfalls. Mistakes usually stem from not considering how long the investment might last, or failing to get advice from experienced financial advisors.

1 Setting the rent too high.

Rental income is not subject to payroll taxes like wages, so practice owners who also own real estate have a clear incentive to pay themselves less in salary and more in rent. Be sure to get the advice of an experienced tax advisor to ensure rent and salary are set at levels that align with IRS guidance.

2 Not thinking through the ownership structure.

Experienced legal advisors can help set up appropriate ownership to facilitate the separate transition of the practice and real estate, and protect the owners from personal liability.

3 Building or buying for today instead of tomorrow.

Smart owners design and build with future expansion in mind. There's nothing more frustrating than being stuck in a building that can't be expanded to accommodate a growing practice, with too few operatories and a tiny parking lot.

4 Choosing a 'C' location.

While a dental practice likely doesn't need an 'A' location (see Section 03), many dentists make the mistake of choosing a 'C' location that's far off the beaten path or stuck in a professional park because they're hesitant to commit to the long-term expense of a 'B' site. For a well-run dental practice, an investment in a 'B' location will more than pay for itself in patient marketing (think: highly visible signage) and long-term wealth creation.

5 Buying a practice without a clear path to owning the real estate.

The flip side of the dentist who transitions the practice separately from the real estate is the younger dentist who buys the practice without also negotiating the purchase of the building, even if the real estate transaction takes place over a longer time. Buying the practice first might leave the purchasing dentist as a long-term renter whose only option is moving.

05 How to Succeed in Dental Real Estate

FIVE KEYS TO SUCCESS

When done thoughtfully and properly, investing in dental real estate can be a straightforward, low-risk method for most dental practice owners to create long-term wealth. As with other commercial real estate ventures, a long-term stable tenant with positive cash flow (like a dental practice owned by the landlord!) is the right place to start.

1 Study the market.

Real estate is, and always will be, a local business, so spend the time to know the local market. Talk with local real estate agents, drive around and through retail and residential zones, look for locations that are up-and-coming, knock on doors, and commission a demographic study. When it comes to real estate, local knowledge is power.

2 Find a location in the dental 'sweet spot.'

Understand the property grading scale, and find a 'Goldilocks' location that's somewhere between 'A' and 'C'. Don't spend too much, but don't spend too little, because the office itself can be a practice's best practice-building tool, with patients referring their friends, and new patients finding the practice as they're driving by.

3 Begin with expansion in mind.

Don't just think about today, consider tomorrow's needs as well. Be sure the location has land for the addition of operatories and parking spaces in the future. Build more operatories, even if dental equipment is added later.

4 Consider other tenants.

If the real estate opportunity is right, add other tenants: other dentists or specialists (either in the core building, or in a separate suite), related healthcare professionals, a dental laboratory, even other retailers who might fit the location.

5 Transition the practice separately from the real estate.

Develop a plan with key legal and financial advisors that allows the practice to transition or be sold on a different schedule than the real estate, if desired.

06 Getting Started

Dentists seeking to begin the process of investing in dental real estate should begin by taking three concrete steps.

Partner with local professionals (agents, brokers, dental sales professionals) who can explain the dynamics of the local real estate market.

Invest sweat equity getting to know the local area, walking and driving through neighborhoods, knocking on doors, looking for new building projects that might signal a market on the way up.

Additionally, don't be afraid to reach out proactively to the owner of a property that's not for sale if it's the perfect location for the practice.

Identify experienced financial and legal advisors who can provide the advice and tools necessary for successful long-term ownership.

07 Conclusion

"Don't wait to buy real estate. Buy real estate and wait."
- 20th century Humorist Will Rogers

For private practice dentists, dental real estate can be the best investment they make over their entire career. In fact, some dentists find, as McDonald's CEO Ray Kroc did, that they build more long-term wealth in their building than in their practice.

When done properly, dentists are almost always better off as buyers than renters. The process begins by understanding the basic principles of commercial real estate investing. That knowledge, when combined with a little research, time, and moxie, can become a source of long-term financial success for those dentists willing to take the plunge.

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BENCO DENTAL IS THE LEADER in cutting-edge dental practice theory, systems and design. They drive dentistry forward through their innovative solutions and caring family culture. Benco is the country's largest family-owned dental distributor with 1,400 associates across the U.S.

ABOUT CAIN WATTERS:

CAIN WATTERS' SPECIALIZED WORK within the dental industry supports the growth of thousands of clients in all 50 states. Their comprehensive financial services integrate sound accounting practices and proactive tax planning with opportunities for profitability improvement. For over 35 years, their approach is enhanced by solid money growth strategies combined with a firm understanding of the factors that will impact one's overall financial success. For more information visit cainwatters.com.

This white paper is one in a series of information on best practices. For more information, visit us at benco.com.

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