Dentist opportunities lost and gained plus property pitfalls

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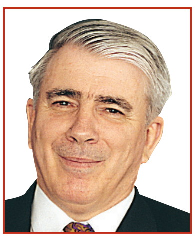

"Property spruikers giving property advice seminars are a conduit for selling real estate which would be difficult to sell through normal agents or auctions... Nobody ever bought a high-quality property cheaply through attending a property seminar..."

Rod bought an associateship in a suburban practice which had two arms in suburbs about 5km apart. A little while later, the other associate also sold to a younger dentist, Timmy. Rod had faster hands and better chairside presentation than Timmy and a community profile through participating in productions of the local amateur theatre group. He received regular mentions in the local press as a result. Timmy had indulgent parents who had bought his practice and helped finance his house. When he needed to purchase Rod's share of the premises, they assisted by providing other property as additional security. As a result, Timmy lacked personal drive, as life for him was too easy.

Inevitably, Rod and Timmy separated, with each taking one arm of the practice. Rod took what initially appeared to be the weaker half in rented premises. Timmy bought Rod's equity in the main premises.

Subsequently, Rod quickly built his practice and within a short while, had acquired a good practice site with an old building which he demolished and built functionally well-designed premises. Several years later, Rod now employs a full-time dentist and a part-time dentist, but he remains easily the highest fee generator; attracts most of the personal referrals and produces great results. He is well-placed to maintain his practice despite increasing competition.

Timmy receding

Timmy's practice has receded. He appears disinterested to staff and patients and as a result, patients leak to surrounding practices. He is at risk of his practice becoming non-viable.

Rod's progress

Rod started out poor, but has upgraded his first dwelling to an attractive long-term home and has strong finances, including a healthy amount of superannuation. He has built up an extensive patient list who are bonded to him and his practice. His practice seems impervious to the increased competition in dentistry.

Dickie

Dickie bought a small suburban run-down practice about 18 years ago in rented premises. Two competing dentists had practices within about 50m either side in what was considered to be an attractive suburb. Initially, Dickie wondered whether he had bought a lemon, but on getting advice, he put aside the fact that he didn't own the premises, nor was the landlord likely to sell to him and invested in upgrading its appearance and amenities, including installing a toilet, rather than have patients directed up the corridor. Attractive signage and tasteful decoration throughout greatly changed the ambience.

Communication style

Dickie had a quirky communication style which appealed to patients, and his personal referrals took off. His practice was much better presented than the nearby competitors and in a tasteful way. Patients referred to Dickie became long-term patients. Dickie too has fast hands and his fees reflect that his practice is located in an area with above-average incomes. Dickie has upgraded his long-term home, which he owns debt-free and he has a healthy superannuation fund.

Jamie

Jamie was always amenable to a good story. Greedies, an accounting practice which had wined and dined her graduating class of dentists and offered to do their first year's tax return for 'free', had one of its advisers sell her an overly-expensive insurance policy and, through a closely-aligned property arm, got her to gear into two investment units, both of which had a rent guarantee for the first twelve months. Subsequently both produced poor rental returns after expenses and both fell in value. Nobody had told Jamie that if property units had to be flogged via accountants, they had already failed the open market test. Nor did anybody tell her the pitfalls of rental guarantees. Any property which has to be sold by non-regular means is either overpriced or has significant fault. It took several years before Jamie realised that she had been sold overpriced lemons.

Jamie meets Phil Hispockets

Feeling a little lost, Jamie made some enquiries and was introduced to a charismatic accountant, Phil Hispockets, who drove a Rolls Royce. The Rolls Royce should have been a warning sign. Hispockets told Jamie that she had a tax problem, but fortunately there was a solution. After an elaborate presentation on a large whiteboard full of figures, with arrows looping back from tax savings, Jamie found herself signing up for a loan to purchase $500,000 of eucalypt plantation investment.

Almost immediately, Jamie found herself dealing with a subordinate in Hispockets' firm, as once the sale was made he quickly passed her down the chain. The eucalypt sale had netted Hispockets' practice $50,000 in commissions. The reality was that Hispockets made his big bucks from fast sales of dud plantation investments, after which he quickly moved on to new clients, while palming off his latest investor to a subordinate in the firm.

While Jamie had a reasonable dental practice, it could have been much better, but the accountants in neither firm had given her any meaningful analysis of her dental figures. The principals of both Greedies and Hispockets told their subordinates to not waste any time on "dental crap", telling them that "we're here to make money by selling the clients investments which generate substantial commissions and consultancy fees to our firms". Jamie found herself with lots of debt and unlike many of her peers, was still living in a modest first home with a substantial mortgage.

The annual summation of her tax savings via her negatively geared investments had been depressing. Since the investments had declined in value, she would have been better off not having the investments, paying the tax and having more after-tax income and personal cash flow.

The eucalypt company collapses

The eucalypt management company collapsed into a morass of losses, dodgy accounting and legal actions, but Jamie found that the documentation on her $500,000 loan from a bank had been well-prepared by the bank's lawyers and she had signed all of the appropriate acknowledgements and disclaimers. She herself had not really noticed this while Phil Hispockets was helping her sign the documentation in all the right places.

Jamie has since found better accounting and financial advice, but the two bad accounting experiences, each of which "looked after her" for about six years, meant that she is financially years behind her university graduating peer group.

False dreams

Harold was a UK-trained dentist who migrated to Australia with his family after years of practice in England's National Health Service dental scheme. Shortly after arriving, he purchased a practice which had a reasonable fee base and Harold employed several part-time dentists who, together with himself, occupied three chairs for five days per week.

It may have been his years in the English National Health system, but Harold was a habitual discounter and a soft touch. Although he saw many more patients than other dentists in the practice and was an accomplished dentist, the profitability of his own surgery was poor. Harold had several accountants in turn, as various accountants retired and passed him on to others, but none of them analysed his figures. The truth was that Harold's practice would have been a lot more profitable if it had been run to average standards of fee charge-out and cost control. Although they claimed to have expertise with dentists, none of Harold's accountants had accumulated any meaningful data and what cursory advice they did give was usually about nine or ten months after the conclusion of the last financial year as they handed him his completed returns and invoiced for their services.

Harold continued to muddle along and when the adjoining property to his own practice premises was put up for sale, Harold thought it might be a good idea to build an expanded premises with five or six chairs and asked his accountant for advice. The accountant should have analysed the performance of Harold's practice, but didn't. Rather, he told Harold that it was a good idea. In truth, he was more interested in the fact that having Harold purchase another asset into a trust would create more accounting fees. Harold could have been vastly more profitable if he had done a modest renovation in his existing premises, introduced proper fee protocols and tightened up support staffing, which was costing far above the normal percentage of fee revenue.

A dental island

Unfortunately, Harold was a dental island, oblivious to the true economics of the dental profession. He may have given some brief consideration to various practice management reform issues, but always retreated into his own patient treatments and continued to heavily discount his fees. His own surgery was booked out far in advance of his employed dentists, because his patients sensed that they couldn't be treated as cheaply anywhere else.

Property planning delays

Neither had Harold contemplated the steps and the delays in property development. The house next door was rented out cheaply while he had expensive plans done and brought them to the local council. It took several years and multiple rejections before Harold eventually had his plans approved on appeal. However, the property had only been intermittently occupied and in the meantime it had deteriorated to a virtually unlettable condition. Various builders had urged Harold to proceed. None of the builders had the slightest clue about the economics of the dental profession; they simply wanted to get a profitable building contract and sensed that Harold would be easy to deal with from their perspective.

Poor practice and debt

Meanwhile, Harold's practice had continued to be run poorly and he had significant personal debt. Harold was a dreamer who wanted a big practice but was in self-denial concerning the state of his existing practice. Eventually, those near and dear to Harold forced him to seek alternative advice. His figures were analysed and he was told:

- Sort out your practice in its existing premises; tighten up your fees, stop discounting and do a modest renovation to upgrade the appearance of your practice;
- Forget the grand scheme next door. Given the state of your practice, your weak finances and the time taken to get plans approved (several years) the world has moved on. You may never fill the existing facilities in the new premises you had planned; and
- Sell the next-door block, reduce your debt and focus on your existing practice.

By this stage Harold was financially many years behind his peers and found it impossible to catch up. He found it difficult to face up to his issues and although there was improvement, he found himself working into his 70s before he could contemplate retirement.

Julian

Julian was impetuous. He bought into a practice within three or four years of graduation and his figures and practice benchmarking quickly showed that he was on target to build a nicely profitable practice business.

Julian meets Guru Bob

However, Julian wanted to get rich in a hurry and for him, the logical steps followed by most successful dentists were too slow. Julian was invited to a property seminar and the speaker, commonly known as 'Guru Bob', gave a charismatic performance. He presented startling and, truth be known, quite distorted examples of unnamed persons who had apparently leveraged themselves to great wealth through property acquisition. Guru Bob intimated he knew all of the secrets of how to build a profitable property investment empire, producing positive income. The sky was the limit. Bob claimed to have dealt with many successful property investors and had developed systems for investing in a structured and strategic way.

Bob's talk was mainly hocus pocus. The capital growth figures were a distortion, heavily reliant on misleading median price statistics which ignored owner capital improvements into housing prices in selected suburbs. Examples of unnamed clients who had bought several inner city townhouses and terraces 30 years ago, which had dramatically improved in value, left out the fact that the investors had virtually gutted older buildings and rebuilt virtually all but their facades. The huge amount of additional capital expended on the rebuilds wasn't factored into the buy and sell prices and hence the rate of capital growth claimed was astonishingly high, but also seriously misleading. In any case, neither the properties nor their owners were identified.

The implication of Bob's talk that he had access to quality inner-city terraces and townhouses to invest in was also misleading. The property that Bob actually had access to was decidedly inferior. He got paid high fees by various developers for selling properties. Some of these fees were disguised as consultancy fees rather than commissions, while others involved Bob's organisation being given the option to buy a property with a sale by the developer triggering a payment for cancellation of the option.

Guru Bob had long learned the art of the charismatic salesman's method of communication. He created great empathy with his audience and seeded his talk with enough pitfalls to suggest that he was indeed a really honest sort of guy. The flawed statistics and examples gave the audience the impression that if they could only get Bob to assist them in an investment plan, they would purchase property which would appreciate at twice the rate of inflation. The magic of gearing and rents rising at about twice the rate of CPI could lift virtually anybody into the ranks of multi millionaires if they followed his system.

Bob's captive accountants

Julian discarded his existing accounting and financial advisers, who knew a lot about both dental practices and investment and joined up with an accountant introduced by a member of Guru Bob's staff, because that person had told him "You need an accountant who can assist you in your quest to make yourself wealthy and who understands property". Guru Bob's staff harped on Julian's need to make himself wealthy independent of the need to practice dentistry. Besides, they knew that Julian's current advisers would warn him about the perils of investing in second-class properties and they wanted to separate Julian from them. Julian heard what he wanted to hear from Guru Bob's staff member and changed accountants to a firm of accountants who "understood property", by which Guru Bob's staff really meant "accountants who won't rock our boat by questioning the transactions that we propose".

Bob's accounting mates extolled the virtue of Bob's organisation, and despite their supposed understanding of property matters, seemed little interested in the transactions in which Bob's staff had got them involved. That firm of accountants knew that if they were kindly toward Bob, he would continue to channel clients to them.

Julian had been so impressed with Bob's presentation that he readily agreed to be guided by Bob's staff and quickly found himself buying apartments in three tall towers, all of which required him to be heavily negatively geared. Bob's staff had provided schedules showing cash flows and tax effects over a ten-year period. Closer inspection would have revealed that this assumed the rate of capital appreciation was twice the average increase in CPI of recent years and that rent was assumed to grow at this advanced rate as well. Little did they realise that further tall apartment towers were already in contemplation nearby, nor did anybody tell Julian that he could have bought significantly cheaper apartments in the towers completed one or two years ago, which were only a short distance away.

Still, interest rates were at their lowest point for fifty years and the negative elements of the purchases were easily accommodated within Julian's dental income.

Julian meets the champion unit salesman

Sensing that he was an easy sell, Bob's staff had marked Julian down for further attention. They had recently acquired the services of the "champion unit salesman" from the Gold Coast, which had been suffering one of its periodic declines in property values. Bob's staff were pleased to introduce Julian to this salesman, Tony Sleek. Sleek was immaculately groomed, impeccably dressed, had a polite manner and was extremely personable. He was a champion salesman, but he was also very mobile. He could sniff a downturn in a property market ahead of anybody else and would quickly reposition himself in a new market where he could use his skills and avoid any annoying follow-up from those who he had sold to in the prior location. He was more than happy to move to a new pasture with easy pickings.

Bob's friendly solicitor

Sleek was ever so polite and disarmingly helpful. Potential investors were so taken with his charm and the quality of his presentation of facts that they rushed to sign purchase documents and write out deposit cheques. Sleek was ever helpful when it came to introducing them to lenders or to a friendly solicitor Bob knew who would check the documentation for them and who naturally was dependent upon both Guru Bob's organisation and the friendly firm of accountants to provide a constant source of clients to his law practice. Sleek indicated to Julian that what he really needed was to achieve a property portfolio capable of generating sufficient annual rent to free him entirely from dental practice. All he needed to do in the meantime was to continue to buy apartments as Sleek recommended and Sleek and Bob's pet banker would arrange the finance.

Bob's pet banker

The pet banker did very well out of Guru Bob and particularly from Sleek. He got introduced to a number of clients with good incomes for whom he could write large loans and because behind the scenes his bank rewarded him proportionate to the quantum of loan money he had written against his name, he was doing very well.

Interest rate jolt

All went well until interest rates began edging up. Suddenly the superiors of the pet bank lender tightened their criteria for loans and loans which he'd been able to write easily were being rejected because the client's loan to value ratio was outside their newly enforced limits, or because on closer examination the client's income was not quite as good as they had supposed. Very soon they were imposing much stricter limits on financing of apartments than they were for standalone houses. When this occurred, the thriving apartment market suddenly died. Potential buyers could no longer get easy finance and prices fell across the board. Meanwhile, higher interest rates were having their effect in the employment market and some younger tenants of apartments failed to renew their leases and went back to occupying a spare bedroom at their parents' house in order to save money. Overnight, a buoyant rental market turned into a disaster. Julian quickly found himself paying higher interest rates and each time one of his apartments fell vacant, he was advised that in order to re-tenant it, it would be necessary to:

1. Recarpet and repaint the apartment to bring it back up to standard; and
2. Lower the rent significantly in order to meet the market.

In a very short time, Julian found himself stretched financially and decided to sell a couple of his apartments to ease the pressure. He was shocked to find that agents advised that in the current market they could only expect to get around 70% of the price he had paid. This was insufficient to cover the mortgages on these two of his apartments, of which he had acquired a total of ten.

Facing up to losses

Eventually, under great pressure, Julian reduced his property portfolio from ten to five apartments, substantially reducing his debt, but having wiped out approximately $1 million of capital on the five sales, he still found himself with the remainder of his property portfolio performing poorly.

It too had a combined realisable value about $1 million less than Julian had paid.

He was $2 million out of pocket on both realised and unrealised capital losses, but even worse had neglected the necessary renovation of his practice due to cash flow and similarly had foregone superannuation contributions.

His home was well overdue for significant maintenance and he was driving an ageing vehicle. Both his dental income and his net after-tax income were in a poor shape and his overall financial position was teetering on disastrous. His marriage was under severe strain as a result of his poor finances.

Sleek moves on

Meanwhile, Guru Bob's organisation seemed to have shrunk and Bob was busy excusing himself to former clients, blaming the banks for their disastrous policies. Behind the scenes, Bob was exploring whether he could run seminars on syndication of vineyards and olive groves and talking to companies in those industries who were desperate to find new investors. Sleek, the champion unit salesman, had quietly moved on to an organisation providing commercial property services in another city. Sleek had made a lot of money for Guru Bob's organisation and for himself in his previous role as their champion unit salesman and was adept at moving to a new pasture.

Julian was too proud to admit it or to ask them for help, but he belatedly realised the truth of the advice of his initial advisers, who had extolled the virtues of building a good practice and pointed out that owning his own practice premises and his own home would be his two best real estate investments. He also realised that he had been conned by Guru Bob and his staff, but when he went to look at the documentation it was clear that he had signed numerous disclaimers concerning the purchases he had made and on seeking legal advice was told that he had very little chance of winning redress. The legal advice he received indicated that because of the number of properties he had purchased in separate transactions and because each had been run past his accounting and financial advisers, Julian would be regarded as a “professional investor” and had very little chance of gaining satisfaction in the courts. The real truth was that through his own greed, Julian had shot himself in the foot financially.

Lessons

- Successful dentists overwhelmingly make their money through running their practices well and concentrating on prudent financial decisions;
- For most dentists, it’s a case of the harder they work in their practices, the better off they become;
- Dentists’ homes and practice premises are invariably better property investments than are residential rental properties. There are sound reasons why this is so;
- Interpersonal skills and personal drive are key ingredients of success in dental practice;
- High-rise property developers budget up to 20% of their budget for marketing and sales expense to sell apartments off the plan. For this reason, recently-acquired high-rise apartment values tend to fall significantly almost immediately after they have been handed to the buyer;
- The worst time to buy investment properties is at the point where interest rates are at their lowest, since increases in rates will deflate the property market;
- Any property which has to be sold with a rental guarantee is overpriced and is likely to fall in value immediately the guarantee expires and reveals the true rent;
- Property spruikers giving property advice seminars are a conduit for selling real estate which would be difficult to sell through normal agents or auctions. The prices are inflated to cover the substantial rewards to the spruikers and their organisations;
- Nobody ever bought a high-quality property cheaply through attending a property seminar;
- The best property salesmen and saleswomen are extraordinarily empathetic and helpful. People purchase dud properties from them because they have been so nice. When the buyers come to sell a slightly shop-worn apartment a couple of years later, they find huge difficulty in selling and the true market price reveals itself;
- Residential rental properties have poor income even before paying interest but after allowing for municipal and water authority rates, body corporate expenses where applicable, agents’ rental management fees, repairs and maintenance and insurance costs. Often the net income before paying interest is a measly one or two percent of property value. These types of properties never will be good investments;
- It’s always much cheaper to buy an existing apartment from a normal real estate agent in an established residential tower that is a year or two old than it is to buy one off the plan in a brand new development that is being heavily marketed. Inevitably, the new development you buy into will be overshadowed in turn by an even newer development a short distance away that will also be sold at a premium;
- Charismatic salesmen and women have long been a feature of the property industry. As one part of the property market begins to decline, they are quick to read the signs and move on to a new area or to a different form of property; and
- Firms of accountants or solicitors that are heavily recommended by property spruikers or the selling arms of property developers have invariably been seduced by the knowledge that they must not interfere with the purchase of property because they will put future referrals of new clients at jeopardy if they do.