

Surviving orthodontic graduate debt: Making correct career choices to manage debt re-payment, reduction or forgiveness

Bruce Haskell^a; Thomas Keefe^b

ABSTRACT

Monetary pitfalls and traps await unwary residents upon graduation. The path to a financially satisfying personal and professional life is obtainable despite high student loan debt and limited income. Career and personal finance issues, student loan options, tax avoidance, bank lending policies, and practice purchases are reviewed. Career options of public service, salaried employee, per diem employee, and private practice ownership are compared in personal financial outcomes, taxation, and retirement consequences. (*Angle Orthod.* 2019;89:529–534)

CHALLENGES AND MARKET FORCES

Faced with high student indebtedness and limited income, it is still possible to have a satisfying personal and professional life. More than ever, it requires knowledge of finance, practice management, lending institution policies, and consultation with experienced practice purchase brokers.

To help residents better relate to the financial facts of their new lives, the American Association of Orthodontists (AAO) released an exhaustive orthodontic workforce report in April 2018.¹ Much of the information was reassuring; some was upsetting. Revenues rose slightly despite increasing numbers of orthodontic graduates but did not keep pace with education costs. Within the past 17 years, the Commission on Dental Accreditation (CODA) has granted accreditation to over 10 new programs, whereas other programs have increased their number of residents. This has generated a 47% rise in total enrollment and a 31% increase in graduates. Surprisingly, the increase in graduates has kept pace with population growth and practitioner retirement rates such that the orthodontist/per capita ratio for the US population is at near parity for this period.² Average resident indebtedness climbed from \$348,052 in 2008–2013 to \$456,036 in the period

2013–2017, a 31% increase. The rise in student debt was not reflected proportionately in orthodontic fee increases. In 2011, the median orthodontic fee for adolescents was \$5200, whereas, in 2016, it was \$5610, a 7.9% rise.³

NEW ORTHODONTISTS' EXPECTATIONS

Although “hope springs eternal in the human breast,” (Alexander Pope), false hopes are usually based on incorrect assumptions or misinformation. According to the AAO report, new orthodontic graduates expect to earn close to \$200,000 per annum, whereas the reality is closer to \$163,000.⁴ This gap between expectation and reality can change the financial picture for personal and professional plans upon graduation. Comments appearing in the AAO study indicate the financial situation is causing new graduates to reconsider and delay practice ownership, perhaps working several jobs to generate larger income as a peripatetic traveler with long commutes. In the United States, 84% of new grads want to own a practice; simultaneously, more than 70% said they felt constrained by student debt.⁵

BURDEN OF LOAN REPAYMENT

To make student loan repayment more affordable, the government developed a variety of repayment plans, including the popular income-based repayment (IBR) plans with repayments based on income, not loan amount. IBR plans are intended for individuals with more student debt than annual income, such as graduates with average student loans balances and typical starting salaries. Repayment periods may last up to 25 years. At the end of a repayment period, the

^a Professor, Department of Orthodontics, University of Kentucky College of Dentistry; operated a private practice for 37 years before its sale; former president of the North Atlantic Component, Edward H. Angle Society of Orthodontists.

^b Emeritus Professor of Business, School of Business, Indiana University (Southeast).

Published Online: June 11, 2019

© 2019 by The EH Angle Education and Research Foundation, Inc.

government “forgives” any remaining loan and unpaid interest. The catch is that forgiven debt is treated as a taxable “gift,” taxed as ordinary earned income. For an orthodontic graduate with a typical starting salary and student loan indebtedness, the final tax bill can be several hundred thousand dollars!^{6,7}

Many comments in the AAO Orthodontic Resident Graduate Tracking Survey and AAO Student Loan Survey were grim, such as:

“I have put off marriage, starting a family, and purchasing a home. I’m currently researching alternative employment in a state away from friends/family with a reduced cost of living.”

Additional remarks related a lack of business planning knowledge; how to prepare a “business model” for securing a practice loan; communicating with staff; and operating, managing, and marketing a practice.

“We don’t learn about any marketing/business skills in residency and that is what the majority of my time is now spent on.”

New graduates typically have misunderstanding, antipathy, or fear associated with high levels of student debt.

“I am delaying opening my practice until I am out of debt. I had to choose my jobs based on my student loan debt. I am working at (a) place where I don’t want to be. I commute 80–100 miles 4 days a week because of the increased pay for my student loans.”^{3,5,8}

New orthodontists may avoid such negative experiences. After communicating with students, student loan counselors, practitioners, counselors at the AAO, loan bankers for health professionals, and practice purchase/management experts, several paths exist that allow for future success.

AVOIDING LARGE STUDENT DEBT

- (A) If not yet admitted to an orthodontic residency program, consider one that has lower costs. Private institutions with a mean cost of \$181,000 bestow happiness of a diploma together with a precarious “Debt-Sword” of Damocles. A few orthodontic programs have hospital affiliations with residencies granted equivalency of medical residency status. There is no tuition for such programs, and residents are paid a small salary as required by federal law. Another option is to attend one of many existing state programs that are quite reasonable with an average total cost of \$70,000 for all years of residency. Some state programs may not be in major cities nor in convenient

locations for commercial travel, but are cost effective with exceptional reputations.

- (B) As a resident, live on a budget and use loan monies wisely. A wise executive at our state association said: “If you live like a dentist while a student, you will have to live like a student when you are a dentist . . . ie, *sumptus censum ne superet*.” When possible, avoid spending loan money on discretionary or consumable items! For every dollar borrowed the payback can easily amount to \$2 depending on interest rates and type of repayment program!⁹
- (C) Avoid excessive use of credit cards: Credit cards are an expensive way to borrow money that students often use to make ends meet when expenses exceed income. Budget to match each semester’s expenses and income. Carrying a credit card balance from semester to semester is a sign of a resident living beyond their means.
- (D) Choose the ideal student loan repayment plan for your situation. A traditional 10-year repayment plan minimizes loan interest expenses but maximizes the size of monthly loan repayments. IBR plans may be of interest as a way of minimizing the size of monthly repayment amounts, maximizing cash flow, and positively affecting debt-to-income ratios, allowing a graduate to borrow larger sums for purchase of a practice. Debt-to-income ratios are based on repayment amounts, not loan amounts. Smaller monthly repayments result in better debt-to-income ratios used by bank lending officers to assess credit worthiness of a borrower. Graduates may be attracted to an IBR because they wish to maximize loan forgiveness, thinking of it as a “gift.” Depending on a graduate’s income and student debt, repayments may not even cover the cost of interest so that the total owed grows over the term of the loan, which can last for 25 years! If an IBR is used, we advise putting aside a monthly sum to cover the expected future “loan forgiveness tax.”^{9,10}

REGULARLY REASSESS REPAYMENT PLANS

Graduates with federal loans can change their repayment plan at any time if payments have been kept up to date. Graduates are advised to regularly reassess their loan repayment plans to determine the best plan for their circumstances as income and needs change. Choice of a repayment plan should provide the best opportunity for a graduate’s future, based on factors such as desired lifestyle, career choice, impact on cash flow, ability to borrow, overall costs, taxes, as well as debt forgiven. Starting with an IBR may be best when annual income is significantly less than amount

owed; then, later, one can switch to a “standard plan.” As income grows, it may be advisable to pay off a student debt early, minimizing interest and avoiding the need to pay a “forgiveness” tax. Be aware, however, that using earned income to pay off a student debt too quickly may not be financially advantageous from a tax or cash flow perspective. Using income to fund a 401(k) plan reduces that year’s adjusted gross income (AGI), which determines the size of income-based repayments and income taxes. A smaller AGI leads to small repayment amounts, better debt-to-income ratios, and lower taxes. Paying into a qualified retirement plan has the distinct advantage of placing compounding on the graduate’s side, as a retirement account builds over time.⁹

PUBLIC SERVICE EMPLOYMENT AS AN OPTION

New orthodontists are not often interested in public service positions, preferring private practice. However, combining participation in the federal Public Service Loan Forgiveness Program (PSLF) with an IBR plan may make this an attractive alternative. Under the College Cost Reduction and Access Act of 2007, federal student loans may be forgiven for those who commit to public service. This may include education, social work, public health, military, and other jobs for the public good.¹⁰

The PSLF Program forgives, tax-free, the remaining balance on direct loans after 120 qualifying monthly payments are made under a “qualifying” repayment plan while working full-time for a “qualifying” employer. Based on income, not loan amount, an IBR plan will minimize the size of monthly payments and maximize unpaid principal and interest for individuals whose loan amounts exceed their income. Thus, the tax-free value of a forgiven loan plus after-tax income of a public sector job may exceed after-tax income earned in the private sector.

AVAILABILITY OF PUBLIC SECTOR EMPLOYMENT

A search found public sector positions for orthodontists to be competitive and limited in number. Also, requirements and benefits change over time, and vary from agency to agency. Positions may be available with the US Public Health Service, National Institutes of Health (NIH), or National Health Service Corps. Details are situationally specific! Indian Health Service positions can dismiss \$20,000 per year of student debt with employees given an additional \$4,000 for tax on the forgiveness. Consult repayment opportunities at www.ihs.gov/loanrepayment.¹¹ Once popular and available, military options for orthodontists are disappearing. Few orthodontists are recruited per year for the US

Air Force, but with generous resident scholarships of \$45,000 per year in addition to service pay and benefits. Currently, orthodontists are not being recruited for the US Army, with dependent care likely to be assigned to the private sector in the near future.¹²

Orthodontists with prior military service may wish to continue in the active reserve or serve as reservists in general dentistry, an excellent opportunity to earn a generous salary including an inducement sign-on bonus for one weekend per month and a 2-week assignment per annum. Reservists may dismiss \$40,000 per year (forgiveness tax due), up to \$250,000. Check with a military recruiter for details as mission needs change.¹²

CONFUSION!

Currently, a great deal of confusion surrounds the PSLF program as only 206 of 41,000 general applicants having loans were “forgiven” as of September 2018. One should not automatically assume that working for a “public” agency (including teaching) qualifies, as only some federal plans are eligible for forgiveness. The Department of Education wants participants in the PSLF program to submit an Employment Certification Form each year to assure meeting program qualifications.¹⁰ Resubmission should be made if the agency changes its mission, or if a job is changed to a different agency. Check with your loan servicer. All promises, loan forgiveness, and employment options to participate should be in writing.

PRACTICE PURCHASE AS AN OPTION

Purchasing a practice may be a solution that can pay off both school and operational debt. Purchase price of a typical practice is often 80% of gross revenues, or 1.8 times net, assuming equipment is fairly new, the location reasonable, and it is not Medicaid based. This is because “contractual receivables” exist for most active orthodontic patients, something other dental practices usually lack in large degree. With a typical practice costing between \$400,000 and \$1.4 million, an average practice may cost \$650,000. With a common net overhead percentage of 57%, it may yield an initial net income of \$310,000–\$350,000 annually, compared with an income of \$163,000–\$180,000 as an employee. In the former scenario, investing in oneself as an orthodontist yields nearly a 4:1 return compared with a rather risky 10% (or less) return by investing in the S&P 500.^{13,14}

Even burdened with student loan debt, bankers typically lend to an orthodontist because they know they are transacting with a stable health care provider in a good “practice-for-life” business arrangement. As only 1% of health care professionals default on loans,

Table 1. Career Path Comparison

Career Path	Federal Employee	Employee for Private Employer	Employee at Per Diem: \$1,210 ^b	Owner
Annual income	\$130,000 ^a	\$163,288	\$242,000	\$349,375
401(k) contribution	\$18,500	\$18,500	\$18,500	\$18,500
Adjusted gross income (AGI)	\$121,200	\$144,728	\$223,500	\$330,875
Student debt	\$456,036	\$456,036	\$456,036	\$456,036
Practice debt, line of credit				\$650,000, \$20,000
Initial monthly income-based student loan repayments	\$777	\$1,054	\$1,711	\$2,606
Monthly set aside for taxes on student loan forgiven but taxable	\$0	\$645	\$333	\$55
Mortgage	\$250,000	\$350,000	\$350,000	\$350,000
Car loan	\$35,000	\$35,000	\$35,000	\$35,000
Initial basic monthly living expenses. ^c	\$2,691	\$2,691	\$2,691	\$2,691
Debt forgiven				
After 10 years	\$663,489			
After 25 years		\$1,240,201	\$556,868	\$92,198
Taxes on debt forgiven ^d	\$0	\$491,120	\$220,520	\$36,510
Initial income adjusted for benefit/cost of debt forgiveness	\$196,349 (\$130,000 + \$663,489/10)	\$193,251 (\$163,288 + [1,240,201-491,120]/25)	\$255,454 (\$242,000 + [\$556,868 - \$220,520]/25)	\$351,603 (\$349,375 + \$92,198 - \$36,510)/25)
Annual income at retirement ^e	\$407,425	\$511,751	\$758,437	\$1,094,954
Estimated 401(k) retirement savings	\$5,417,850	\$5,417,850	\$5,417,850	\$5,417,850
Estimated practice value at retirement ^f				\$1,814,712

^a Based on employment in the Indian Health Service (USPHS): Salaries \$130,000–150,000 depending upon experience and qualifications.

^b Annual per diem salary (calculated at 200 annual working days) posted by Indeed, Inc. 6433 Champion Grandview Way, Austin, TX 78750.

^c Based on keeping expenses equal to, or less than incomes for lowest income career path. Surplus spending at discretion of individuals.

^d Due in year forgiven.

^e Increases first 5 years, 5%; next 35 years at rate of dental inflation, 2.6%.

^f Based on dental services inflation.

an orthodontist is potentially a great customer! Currently, rates of 5%–5.65 % interest for practice purchase appear customary. Loans of over \$500,000 often allow for the lower interest rate! The older concept of “sweat equity” for buy-in through earning less income while working the practice in lieu of an immediate cash purchase is less common as cash is usually available at reasonable interest rates.^{14,15}

PURCHASING A PRACTICE

When approaching a banker with a potential practice purchase through a broker, go with a comprehensive “business plan” of practice gross, net, employee, operational, and physical plant costs in hand. Demonstrate how much is needed to run the practice, and pay back student loans as well as required funds for living expenses. Your practice acquisition broker will help. The banks will demand the seller’s profit/loss tax reports over several years to see if the practice for sale is a viable one. Considering the total level of indebtedness required for this career path, one should have a modicum of clinical skill, practice speed, knowledge, and the capability to run a sizable practice before purchase.^{14,15} Although difficult to first appreciate, acquiring a large “good” debt as an investment with an accrued value is a viable *modus operandi*.^{16,17}

CAREER PATH FINANCIAL OPTIONS

The “Career Path Table” (Table 1) was developed to compare the finances for four career choices facing a new orthodontist with an average student debt load. (a) New federal employee’s income was based on discussions with federal agencies.¹¹ (b) Newly hired doctor–employee income was based on AAO surveys.^{1,3–5} (c) A per diem employee at the highest pay level had income for 200 days of employment projected from a national survey. (Indeed Inc., Austin, Texas). (d) As a practice owner, assumed predicted income and practice purchase price were dependent upon revenues and costs for an average practice and based upon knowledge of an experienced national practice broker.¹⁴

CONSTRAINTS IN THE MODEL

Expenses could not exceed income. This meant that after taxes and debt repayments, net monthly income had to be equal to or greater than initial basic monthly living expenses shown in the table. The model implies that income would go up 5% each of the first 5 years, then by the rate of dental service inflation: 2.6% (US Department of Labor). For purposes of simplification, each model assumes 401(k) contributions of \$18,500 annually toward retirement. The 401(k) monies are

assumed to appreciate at 8% per year, with resulting accumulations shown in the table that follows. It is assumed that as incomes increase and debts are paid off, excess disposable funds are available for other purposes (eg, building purchase, child tuition costs, costlier home, retirement, living expenses, and so on). For a public service career, student debt is forgiven after 10 years. For the practice owner, the office loan is completed after 10 years with student loan repayments continuing for another 15 years. Similarly, excess monies may be used elsewhere. For all pathways except public service, taxes become due on the forgiven student debt in the year student debt is forgiven. Financial decisions are, of course, individual choices. Retirement savings are shown so the reader may understand what is possible with reasonable diligence. Reality, however, can defeat all financial planning, as “expenses rise to match income!”. . . a catchphrase for spend-thrift expenditures!

COMPARISONS OF ESTIMATED RETIREMENT SAVINGS

In all cases, retirement savings were assumed to come from several sources: initial savings (set at \$0 in the examples), 401(k) contributions, excess income above basic living expenses, and excess income after loans were paid. For the individual who chooses to buy a practice, the estimated practice value was assumed to grow at the rate of dental services inflated (2.6% per year) over a 40-year work life to \$1,814,712.

PUBLIC SERVICE EMPLOYMENT AND DEBT FORGIVENESS

Although opportunities for public service orthodontists may be limited and competitive, it is surprising how attractive such an opportunity is given considering security and retirement outcomes. When combining an IBR plan with PSLF, all orthodontic student debt is forgiven tax free after just 10 years (see previous caveat!). A pay-as-you-earn (PAYE) repayment plan holds down the size of monthly payments when annual income is significantly less than the size of student debt. PAYE repayment plans become less valuable as income increases. An increase in income will raise the monthly payment size but it also reduces the residual value of debt forgiven.

When making a career choice, if a PAYE repayment plan is not combined with a PSLF program, the taxes owed at termination must be considered and not just the debt itself. Three of the choices examined in the table present very different levels of final “forgiveness” tax. Many residents and residency applicants queried were overly focused on maximizing debt forgiveness without considering the tax due at loan termination and

the resulting disastrous cash consequences for some (Table 1). Thus, the higher the marginal tax rate/tax bracket at debt termination, the more money owed to the government, amplifying the effect on cash flow in that year! Additional information is available at: (a) The American Student Dental Association website, www.asdanet.org, and (b) 2017 Webinar: Student Loans: Controlling the Cash Flow available on request to AAO members.^{18,19}

CONCLUSIONS

- Despite high debt levels and limited incomes, the financial futures of orthodontic residents and new practitioners appear bright. Residents need to focus on cash flow analysis when making career choices and spending decisions. People frequently overestimate income and underestimate expenses. This can result in severe financial consequences.
- It is no longer enough to be trained as a highly competent practitioner. The new reality of high student debt requires financial savvy as well.
- New practitioners should employ the services of a financial advisor familiar with orthodontic practice before making decisions for major life events such as relocation, marriage, birth of a child, major purchase such as a home or practice, and a retirement account. Armed with knowledge and a study of loan and tax obligations, finances, and budget planning, better times are coming . . . *auspiciis melioris aevi!*

REFERENCES

1. American Association of Orthodontists. 2017 Workforce Report. AAO. St. Louis, MO.
2. American Association of Orthodontists. Orthodontic Resident Graduate Tracking Survey, December 2016-December 2017.
3. American Dental Association. Health Policy Institute. Survey of Dental Fees: 2011-2016.
4. American Association of Orthodontists. 2016 Economics of Orthodontics & Patient Census Survey, July 2017.
5. American Association of Orthodontists. Student Loan Survey, January 2018.
6. A Report of the ADEA Presidential Task Force on the Cost of Higher Education and Student Borrowing: American Dental Education Association, 2013.
7. Public Service Loan Forgiveness: What Every Dental Student, Resident and Fellow Should Know: Quick Facts About Public Service Loan Forgiveness (PSLF) American Dental Education Association, February 2017. Available at: https://www.adea.org/uploadedFiles/ADEA/Content_Conversion/Current_Students/ADEA-Public-Service-Loan-Forgiveness-Two-Pager.pdf
8. Dentistry is the Number 1 Job in America for Debt <https://www.studentloanplanner.com/number-1-job-america-dentist/>.
9. American Association of Orthodontists: Practice Management Section, St. Louis, MO.

10. Korte G. How Public Service Workers Can Get Student Loans Forgiven, USA Today, International Edition. December 31, 2018.
11. General Information: Indian Health Service of the USPHS, December 2018. Available at: <https://www.ihs.gov/loanrepayment>. Accessed May 7, 2019.
12. Health Professions Recruitment Offices: US Army and US Air Force, December 2018.
13. Investopedia Website, an on-line reference source for the investing public. <https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp>
14. Alexander K. General Information. Practice Broker, Carlsbad, CA.
15. General Information: Professional Loan Bankers, Chase Bank, Louisville, KY.
16. Scholtz RP. Orthodontic Education - The times they are a changin'. *Angle Orthod.* 2011; 81: 1111–1112.
17. Mike Meru Has \$1 Million in Student Loans. How Did That Happen? *The Wall Street Journal*. May 25, 2018. Available at: <https://www.wsj.com/articles/mike-meru-has-1-million-in-student-loans-how-did-that-happen-1527252975> Accessed May 7, 2019.
18. American Association of Orthodontists. 2017 Webinar - *Student Loans: Controlling the Cash Flow (available on request to AAO Members)*.
19. American Association of Orthodontists. 2018 Video Financial Presentation for Residents (*available on request to AAO Members*).