



Buying and Selling a Dental Practice – the legal process

Part 4: Funding and Security



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Most dentists seeking to purchase a practice need funding for the acquisition. Few are in the fortunate position to be able to fund the acquisition with their own cash, and indeed if they are it is often

not financially sensible to do so when that cash could be growing at a greater rate than borrowed funding would cost.

There are two principle ways of raising finance – debt and equity. Debt finance is borrowing money from a financial institution and is by far the most common way of funding a practice purchase. Money may also be raised by way of equity funding - an injection of capital from an investor in return for a stake in the business (eg. shares). In the dental sector, this is less common, save for buy-ins to existing partnerships.

Availability of debt finance

Even during the recession, banks have continued to fund the acquisition of practices to 100% of the purchase price and more.

However, the willingness of banks to lend depends on the way in which the potential purchaser is scored by the banks and the risk to the bank.

Consequently, banks tend to prefer to lend to partnerships of dentists rather than sole practitioners, practice managers or dental nurses and banks

will consider the age and record (disciplinary) of the dentists.

For example, banks may favour a number of joint borrowers as they collectively own more assets that the bank could use to seek repayment in the event of default.

A borrower below a certain age may also be preferred as it is more certain that a dentist below a certain age shall have a longer working period ahead of him during which he will be able to repay the loan.

The bank will also be keen to consider the turnover, expenses and profits of the business and will require the latest accounts in order to assess whether the practice will be sufficiently profitable to enable the borrower to repay the loan.

Special care must be taken in relation to obtaining funding for NHS and mixed practices.

This is because a PDS or PDS Plus contract can be terminable within a short period of times (eg. 5 years) and whereas a PDS contract holder may revert to an open-ended GDS contract before the expiry of the term, this is unlikely to be possible with a PDS Plus contract as only the UDA component (51%+ of the contract value) transfers to the GDS contract.

With target acquisitions that include NHS contracts, the bank often requires confirmation (from the buyer's solicitor) of the route to be taken in relation to the transfer of the NHS contract or that the PCT has confirmed that they consent to the transfer.



Banks will also often wish to receive confirmation that any historical claw-back that a PCT may seek to recover under a PDS or GDS contract will remain the ultimate liability of the sellers, not the borrowing buyer.

It is often a term of the lending that the buyer takes out and maintains life insurance so that if the buyer dies the proceeds of the insurance may be used to repay the loan.

If the practice premises are leased, then the bank will prefer (or require) the lease to have a number of years left to run and that it is protected by the Landlord and Tenant (Leasehold Provisions) Act 1954 – i.e. it can be held over and run on after the initial term has expired.

Terms

A bank loan may be repayable on an interest only basis, in which case consideration should be made to how the loan capital will eventually be repaid (eg. out of the proceeds of the sale of the practice if it is ever sold) and of course the monthly repayments are lower than a loan which requires capital and interest be repaid in monthly instalments.

The interest rate (normally a certain number of percentage points above the current base rate) and the fees payable to the lending institution may be a point on which shopping-around and negotiating with the institution may result in reductions and a better deal.

Documentation and agreements

The bank will wish to take security over the loan so that if the borrower defaults the bank can appoint a receiver to sell the assets over which the bank has security in order to attempt to recoup its loan.

Consequently, the borrower is required to enter into various agreements which provide the bank with such security.

These include:

- Charge

A charge is security (a right to sell and take the proceeds in certain circumstances) over specific assets, for example the practice premises. A charge over property (land) must be registered with HM Land Registry. However, a charge can also be taken over other assets belonging to the borrower. It can also be security over all monies owed at any time by the borrower to the bank (eg. an overdraft) – not just the practice purchase loan.

- Debenture

A debenture is a charge over all the assets, present and future, of a company. This is often required by the bank if the borrower is a company (i.e. the dentist is using his company to purchase the practice). A debenture must be registered with the Registrar of Companies (“Companies House”) to be valid.

- Personal Guarantees

If the borrower is a company, then depending on the credit history, assets, size, liquidity (cash), success, prospects and directors of the company, the bank will not want to risk not being repaid in the event the company is wound up. Instead, it will require the shareholders or directors (the persons behind the company) enter personal guarantees whereby they agree to meet the obligations of the company from their own assets in the event that the company defaults. This obviously defeats the benefit of limited liability in relation to the use of a company in so far as liability to the bank is concerned.

The lending institution will require fees to be paid in relation to arranging the funding (“arrangement fee”) of a fixed price or percentage of the purchase price, valuing the target acquisition (“valuation fee”) and preparation of the security documents (“security costs”). Often the bank will enlist the assistance of the buyer’s solicitor to enable these

documents be executed – the additional costs of the solicitor in relation to this have to be met by the buyer.

Other options

Equity finance is available for a few large corporates. It is possible for a successful corporate to attract an outside investor who is willing to inject cash into the business to fund expansion and acquisition in return for shares. That investor will often require preferential treatment with regard to dividend payments every year but will also be seeking a windfall in the event of a future sale of the company.

A partnership seeking funds to expand may consider admitting new partners in return for an injection of capital from the new partners (they ‘buy-in’ to the partnership). That capital may be used for an acquisition.

There are also often various changing government schemes and grants which may be available to expand, acquire new practices and assist start-up businesses – a dentist’s first practice.

Funding and the seller

The seller (or the agent or his solicitor on the seller’s behalf) will often require evidence that the buyer has arranged funding for the purchase or has a decision in principle. The buyer will not want to waste precious weeks or months negotiating and dealing with a buyer who cannot ultimately secure funding and therefore cannot buy the practice.

Therefore it is also wise for any buyer to at least obtain an indication from potential funders that they would be willing to lend, before risking a deposit (which may be lost if the buyer cannot secure funding), legal and accountancy fees and the cost of any searches.

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