Taking Care of Business

By Camilla McLaughlin

Not too long ago, all a real estate agent needed to be successful was a nice suit or dress, telephone, decent car and typewriter. Today, the tools of the trade are likely to include a couple of computers, multifeatured phone, fax, a fully equipped home office, ongoing training and a sizable quotient of business savvy — all evidence of the real estate agent's transition from simple independent contractor to small-business owner.

"Agents need to look at themselves as business people, not sales people," suggests Allen Wright, a consultant and Vice President of the Create a Plan Division of career development company Realty U.

Also indicative of how the industry has evolved are the number of new agents who come directly from college campuses. "The industry has matured to the point that it is a serious career for serious business people," observes Steve Goff, Director of Career Development at RE/MAX Premier Group in Plano, TX. When Goff started in the business 35 years ago, real estate was more or less a second job that most practiced part time. New agents typically were in their mid 30s and 40s. Today, Goff says, "Expectations [of consumers] are so much higher; you're not taken seriously if you are part time."

John Mayfield, a consultant, trainer and former owner of a brokerage in Missouri who has penned a number of books on real estate, believes that "agents who really run their business as a small company are so much more successful because they are going at it from a different approach than the typical agent." The presence of agents with this approach, he says, "raises the bar for everyone" in the industry.

Once you establish your business and have a steady income stream, start to plan for retirement and to protect yourself in the event of a disability.

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Most real estate agents require a fully equipped home office and a sizeable quotient of business savvy.

YOU'VE GOTTA HAVE A PLAN

At the heart of every successful small business is a business plan. Rather than a static statement of goals, Wright sees a good business plan as an ongoing process that assesses changes in the market and in response to those changes, tweaks practices that eventually generate revenue.

With a shrinking market and an industry in the process of reinventing itself, it is increasingly essential to know ultimately what and how much revenue results from specific activities, whether it's holding an open house or speaking to community groups. Equally important, according to Wright, is determining the true cost of doing business. "The days of not managing the business are gone," he cautions, and it is essential to understand and measure where revenues are coming from, determine what activities generate commissions and figure out how much real income any one sale generates.

Wright suggests looking at a business as a pyramid with the top — the peak — being the income you must generate. "You've also got to have a personal budget; you need to know what it is you have to contribute to the family budget to survive. The second layer is how many transactions you need to get that income, while all the specific activities you need to do to generate those transactions make up the bottom layer," he explains.

For example, suppose you plan to work expired listings; you estimate you need to contact 30 expired listings to get one appointment and that for every three appointments you will get one listing. That means that you will have to contact 90 expired listings to get one potential closed transaction. The most important question you have to ask yourself, says Wright, is "whether or not this is reasonable in your market area."

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WHERE'S THE MONEY GOING?

Understanding costs is also essential. In addition to the direct expenses related to closing a transaction, agents should also compute their overhead, which Wright defines as "the costs associated with just existing in the industry." The ability to drill down overhead costs to an individual transaction is "really vital in a down market," he says, since increasingly sellers seek lower commissions.

To illustrate his point, Wright uses the example of a sale in the $200,000 price range for which the seller wants to pay a 4% commission. If your overhead is $2,500 per transaction, he says, you know you aren't going to have much left over to pay the broker and other expenses.

More than just a tool for setting goals, a business plan also gives seasoned agents a detailed picture of where money is being spent. They can determine if they are in a growth mode or barely staying afloat, and they have a better way to assess whether or not an activity actually adds to the bottom line.

TAKING IT TO THE NEXT LEVEL

Attorneys and financial planners see income as the determining factor that takes a business to another level. For example, taxes aren't a big issue if your income is low. On the other hand, once income reaches the $50,000 or $60,000 level most experts say agents should begin to consider incorporating to save on taxes and to reduce the potential for an audit. "Anyone who makes $50,000 or more should take advantage of the tax shelters of an S corporation," says Steven Tucker, owner of Small Business Insurance Services in Palatine, IL. Experts also suggest that agents consider forming a limited liability corporation.

Additionally, says Matthew Tuttle, a partner with the Private Client Group in Stamford, CT, once you have established a business and have a steady income stream, you should begin to plan for retirement and to protect yourself in the event of a disability. "As a Realtor you're only as good as your last deal. Once you decide that you want to stop, that's pretty much it," he says.

GOING SOLO

Often overlooked by independent contractors such as real estate professionals are one-person or solo 401(k) plans, says Tuttle, who also authored *Financial Secrets of My Wealthy Grandparents*. Solo 401(k)s were created by changes to the Economic Growth and Tax Relief Reconciliation Act, which took effect in 2002. These plans allow owners of a one-person business (and their spouse) to make more substantial tax-deductible contributions than those allowed under a typical IRA. Maximum total per-year contributions to a solo 401(k) are $46,000 for those under the age of 50 and $51,000 for those over 50.

Unlike a SEP-IRA, which limits contributions to 20% of income, yearly contributions to a solo 401(k) can equal 100% of income as long as they don't exceed the maximum amount allowed. Year to year, owners have the option of varying the amount contributed or skipping contribution all together. Such a plan needs to be set up before the year ends, but contributions can be made before taxes are filed, according to Tuttle.

Another plan, a defined benefit plan, allows for an even greater contribution. However, "It really only makes sense if you are over 40," says Tuttle. "It is something most people aren't familiar with and is a little more complicated and expensive to set up because you need an actuary."

THE HEALTH INSURANCE PROBLEM

Health insurance continues to take a big bite out of real estate professionals' incomes. According to a recent health insurance coverage survey conducted by the NAR, nearly a quarter of the organization's 1.3 million members do not have health insurance. NAR says the reason is the high cost of private insurance. Approximately 91% of those surveyed believe the U. S. health care system should be reformed and 82% believe the current health care system is not meeting the needs of most Americans.

Unless they happen to live in one of the 33 states that have a guaranteed risk pool, independent contractors such as real estate professionals can have difficulty getting insurance, says Tucker. Recently, a bipartisan group of legislators introduced a bill in the Senate that would

Setting New Goals?

No matter when you begin a new year for your business, Bernice Ross, Ph.D., owner of realestatecoach.com, recommends starting with a clean slate. Review old goals, declare each to be complete (whether or not you've fulfilled them) and dispose of them in some creative way. "Clearing out your list of goals opens the door for new things to come into your life," explains Dr. Ross.

Next, she suggests you:

- Reduce the size of your list by at least 50%. Keep your energy focused on achieving two or three core goals to increase your probability of success.
- Identify the top five activities that worked for you last year and continue them into the new year.
- Eliminate at least one activity that doesn't support you or make you feel great.
- Focus on process rather than outcome; focus on what you need to accomplish at a given moment in time.
- Remember, too, the wisdom of Lao Tzu who said, "A journey of 10,000 miles begins with a single step."

establish the Small Business Health Options Program. This program would encourage states to reform small-group insurance markets, which would make premiums for small businesses and those who are self-employed more affordable. It would also develop a nationwide small-business purchasing pool.

Tucker also suggests independent contractors investigate health savings accounts (HSA) and a corresponding qualified high-deductible health plan (HDHP). Basically, an HDHP has deductibles ranging from $1,100 to $5,500 and is geared toward coverage for catastrophic illness. Such plans, according to Tucker, strip away all first dollar coverage but they also cut premiums in half.

Used in conjunction with high-deductible plans, HSAs were created under the Medicare bill signed by President Bush in 2003 and are designed to help individuals save for future medical expenses on a tax-fee basis. HSAs are limited to individuals covered by an HDHP and who are not covered by other health insurance or Medicare. In 2007, according to the Department of the Treasury, the maximum amount that could be contributed to a HSA was $2,850 for an individual and $5,600 for a family. Unlike flexible spending accounts, HSAs are portable and unused funds can be carried over from year to year and invested similar to an IRA.

"More than 10 million people have a health savings account (HSA) or a health reimbursement arrangement (HRA) and these are the fastest growing products in the financial marketplace," observes John Goodman, Ph.D., founder of the National Center for Policy Analysis, a nonprofit public policy research organization. *The Wall Street Journal* dubbed Goodman "the father of health savings accounts."

WHEN YOU CAN'T WORK

Real estate professionals should also look into disability insurance, advises Tuttle. This is especially important for the real estate industry, he says, since unlike other small businesses that can be sold, there is little value in a real estate business if the owner becomes disabled or dies.

Another important consideration, depending on your age, is long-term care insurance, says Tuttle. "If you get it while you are still working, you can take advantage of deductions that you won't get once you retire," he says. The best time to obtain coverage is when you are in your 50s, he notes, because the premiums go up dramatically once you are over 70.

GET BACK-OFFICE SUPPORT

For agents and brokers with a steady and significant stream of income, $70,000 and up, another option is to sign up with a company such as MBO Partners, which offers group benefits and back-office support to independent contractors. Rather than a 1099, MBO's clients receive a W2. Tax deductions are taken off the top each month and clients pay a service fee on a per-transaction basis equal to 5% of billings. Once billings exceed $125,000 the fee goes down to 1.5% for the remainder of the year.

"I've been running all my income through MBO for more than a year, and I am very pleased. Not only am I now totally organized with all my financial and tax information (my CPA loves it), but also with the many benefits I enjoy, including group health and major medical and 401(k). I actually believe MBO saves me more than it costs me,"

PHOTO BY BORA UCAK AT DREAMSTIME.COM

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says Goff. "I now have a team of people watching my finances."

MBO is not a new company, but they created the model for real estate practitioners about a year ago in response to a request from RE/MAX of Texas. It does suggest there might be new ways on the horizon for real estate professionals to configure their business.

AND THE CHANGES KEEP COMING

Meanwhile, changes in the industry and consolidation among brokerages are leaving some with a newfound realization of just how independent they really are. "One of the things I see traveling around is that brokers really have been downsizing in the last couple of years, which means that agents have to learn to be more mobile" in terms of their workspace, Mayfield says.

Another catalyst Mayfield sees pushing change in the market is the growing cadre of newer agents who are tech savvy. "Agents need to look at themselves as a small business and that includes a business plan, a marketing plan, branding and budgeting," he says. New technology, new ways of doing business and new consumer expectations all mean that the real estate business of tomorrow could be as radically different as today's business is from 35 years ago.

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